



LIBRARY OF CONGRESS

Copyright Royalty Board

37 CFR Part 380

[Docket No. 19-CRB-0005-WR (2021-2025)]

Determination of Rates and Terms for Digital Performance of Sound Recordings and Making of Ephemeral Copies to Facilitate those Performances (Web V)

AGENCY: Copyright Royalty Board, Library of Congress.

ACTION: Final rule and order.

SUMMARY: The Copyright Royalty Judges announce their final determination of the rates and terms for two statutory licenses (permitting certain digital performances of sound recordings and the making of ephemeral recordings) for the period beginning January 1, 2021, and ending on December 31, 2025.

DATES: *Effective date:* [INSERT DATE OF PUBLICATION IN THE FEDERAL REGISTER].

Applicability date: The regulations apply to the license period beginning January 1, 2021, and ending December 31, 2025.

ADDRESSES: The final determination is posted in eCRB at <https://app.crb.gov/>. For access to the docket to read the final determination and submitted background documents, go to eCRB and search for docket number 19-CRB-0005-WR (2021-2025).

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SUPPLEMENTARY INFORMATION:

Final Determination

The Copyright Royalty Judges (Judges) hereby issue their written determination of royalty rates and terms to apply from January 1, 2021, through December 31, 2025, to digital performance of sound recordings over the Internet by nonexempt, noninteractive

transmission services and to the making of ephemeral recordings to facilitate those performances.

The rate for commercial subscription services in 2021 is **\$0.0026 per performance**. The rate for commercial nonsubscription services in 2021 is **\$0.0021 per performance**. The rates for the period 2022 through 2025 for both subscription and nonsubscription services shall be adjusted to reflect the increases or decreases, if any, in the general price level, as measured by the change in the Consumer Price Index for All Urban Consumers (U.S. City Average, all items) (CPI-U) from that published by the Bureau of Labor Statistics (BLS) in November 2020, as set forth in the regulations adopted by this determination.

The rates for noncommercial webcasters are: **\$1000 annually** for each station or channel for all webcast transmissions totaling not more than 159,140 Aggregate Tuning Hours (ATH) in a month, for each year in the rate term. In addition, if, in any month, a noncommercial webcaster makes total transmissions in excess of 159,140 ATH on any individual channel or station, the noncommercial webcaster shall pay per-performance royalty fees for the transmissions it makes on that channel or station in excess of 159,140 ATH at the rate of **\$0.0021 per performance** in 2021. The rates for transmissions over 159,140 ATH per month for the period 2022 through 2025 shall be adjusted to reflect the increases or decreases, if any, in the general price level, as measured by the changes in the CPI-U from that published by BLS in November 2020, as set forth in the regulations adopted by this determination.

The Judges also determine herein details relating to the rates for each category of webcasting service, such as minimum fee and administrative terms, in the following analysis. “Exhibit A” to this determination contains the regulatory language codifying the terms of the Judges’ determination.

I. Background

A. Purpose of the Proceeding

The licenses at issue in the captioned proceeding, *viz.*, licenses for commercial and noncommercial noninteractive webcasting, are compulsory. Title 17, United States Code (Copyright Act or Act), establishes exclusive rights reserved to copyright owners, including the right to “perform the copyrighted work publicly by means of a digital audio transmission.” *See* 17 U.S.C. 106(6). The digital performance right is limited, however, by section 114 of the Act, which grants a statutory license for nonexempt noninteractive Internet transmissions of protected works. 17 U.S.C. 114(d). Eligible webcasters are entitled to perform sound recordings without an individual license from the copyright owner, provided they pay the statutory royalty rates for the performance of the sound recordings and for the ephemeral copy of the sound recording necessary to transmit it. 17 U.S.C. 114(f), 112(e). Licensee webcasters pay the royalties to a Collective, which distributes the funds to performing artists and copyright owners. The statutory rates and terms apply for a period of five years. The Act requires that the Judges “establish rates and terms that most clearly represent the rates and terms that would have been negotiated in the marketplace between a willing buyer and a willing seller.” 17 U.S.C. 114(f)(2)(B). The marketplace the Judges look to is a hypothetical marketplace, free of the influence of compulsory, statutory licenses. *Web II*, 72 FR 24084, 24087 (May 1, 2007). The Judges “*shall* base their decision on economic, competitive[,] and programming information presented by the parties” 17 U.S.C. 114(f)(2)(B), 112(e)(4) (emphasis added). Within these categories, the Judges’ determination shall account for (1) whether the Internet service substitutes for or promotes the copyright owner’s other streams of revenue from the sound recording and (2) the relative roles and contributions of the copyright owner and the service, including creative, technological, and financial contributions, and risk assumption. *Id.* The Judges *may* consider rates and terms of

comparable services and comparable circumstances under voluntary, negotiated license agreements. *Id.* The rates and terms established by the Judges “*shall* distinguish” among the types of services and “*shall* include” a minimum fee for each type of service. *Id.* (emphasis added).

B. Procedural Posture

Following the timeline prescribed by the Act, the Judges published notice of commencement of this proceeding in the Federal Register. 84 FR 359 (Jan. 24, 2019). Twenty parties in interest filed petitions to participate in the proceeding. Nine of those petitioners subsequently withdrew from the proceeding, and the Judges dismissed one of the petitioners because the Judges determined that he lacked the requisite substantial interest in the proceeding.¹

1. Negotiated Settlements

The Judges received two settlements, one between SoundExchange and certain public broadcasters and the other between SoundExchange and certain educational webcasters.

¹ The following parties filed petitions to participate: Accu Radio LLC (withdrew), College Broadcasters Inc. (settled), David Powell (dismissed), Educational Media Foundation (joined case of NRBNMLC), Live365 Broadcaster LLC (withdrew), LA RAZA MEDIA GROUP LLC (withdrew), Pandora Media LLC (Pandora), Radio Coalition LLC (withdrew), Sirius XM Radio, National Religious Broadcasters Noncommercial Music License Committee (NRBNMLC), National Association of Broadcasters (NAB), Feed Media, Inc. (withdrew), Dash Radio, Inc. (withdrew), Tunein Inc. (withdrew), National Public Radio (settled), Radio Paradise Inc. (withdrew), SoundExchange, Inc. (SoundExchange) (filing jointly on behalf of The American Federation of Musicians and the United States and Canada, Screen Actors Guild/American Federation of Television and Radio Artists, The American Association of Independent Music, Sony Music Entertainment, UMG Recordings, Inc., Warner Music Group Corp., and Jagjaguwar Inc.), iHeart Media Inc., ICON Health & Fitness Inc. (withdrew), and Google Inc..

a. Public Broadcasters

One of the settlements, among SoundExchange, National Public Radio (NPR), and the Corporation for Public Broadcasting (CPB), addressed rates and terms for certain internet transmissions by public broadcasters, NPR, American Public Media, Public Radio International, Public Radio Exchange, and certain other unnamed public radio stations for the period from January 1, 2021, through December 31, 2025. The Judges published the terms of the settlement in the Federal Register on October 29, 2019. The Judges received no comments on the proposal and approved the settlement on February 28, 2020.²

b. Educational Webcasters

The other settlement, between SoundExchange and College Broadcasters, Inc. (CBI), addressed rates and terms for certain internet transmissions of sound recordings by college radio stations and other noncommercial educational webcasters for the period from January 1, 2021, through December 31, 2025. The Judges published the terms of the settlement in the Federal Register on October 30, 2019. The Judges received no comments on the proposal and approved the settlement on March 4, 2020.³

2. The Current Proceeding to Adjudicate Rates and Terms

The Act provides that the Judges shall make their determinations “on the basis of a written record, prior determinations and interpretations of the Copyright Royalty Tribunal, Librarian of Congress ...” and their own prior determinations to the extent those determinations are “not inconsistent with a decision of the Register of Copyrights” 17 U.S.C. 803(a). Pursuant to 17 U.S.C. 803(b), the Judges conduct a hearing to create that “written record.” To that end, non-settling parties appeared before the Judges

² 85 FR 11857 (Feb. 28, 2020).

³ 85 FR 12745 (Mar. 4, 2020).

virtually for an evidentiary hearing. At the hearing, SoundExchange represented the interests of licensors. Several non-settling licensees also participated in the hearing.⁴

The hearing commenced on August 4, 2020, and concluded on September 9, 2020.⁵ The parties submitted proposed findings and conclusions (and responses thereto) in writing, prior to their closing arguments on November 19, 2020. During the hearing, the Judges heard oral testimony from 33 witnesses (some of them for both direct case and rebuttal testimony) and considered the testimony of eight witnesses on the papers. The witnesses included 13 qualified experts. The Judges admitted 748 exhibits into evidence, consisting of over 900,000 pages of documents (9227 MB of electronic files in eCRB), and considered numerous illustrative and demonstrative materials that focused on aspects of the admitted evidence and the permitted oral testimony.

Pursuant to section 803(c)(1), the initial Determination in this matter was due no later than December 16, 2020 (*i.e.*, 15 days before the expiration of the current statutory rates and terms). *See* 17 U.S.C. 803(c)(1). On July 6, 2020, the Acting Register of Copyrights, at the request of the Judges, exercised her authority under 17 U.S.C. 710 to “toll, waive, adjust, or modify” the timing provision in section 803(c)(1) to account for

⁴ The non-settling licensees were Google, iHeart Media, NAB, NRBNMLC, Pandora, and Sirius XM.

⁵ The hearing was originally scheduled to commence on March 16, 2020, but was delayed due to the coronavirus pandemic. *See Order Granting Joint Motion for Continuance of Hearing* (Mar. 12, 2020) (delaying commencement of hearing until April 28, 2020. In consultation with the participants, the Judges granted several additional continuances, until ultimately scheduling a virtual hearing employing videoconferencing technology to commence on August 4, 2020. *See Order Granting Joint Motion for Second Continuance of Hearing* (Apr. 1, 2020); *Order Granting Joint Motion for Third Continuance of Hearing* (May 1, 2020); *Order on Hearing Schedule and Related Pre-Hearing Matters* (Jun. 10, 2020); *Order Setting Virtual Hearing and Addressing other Hearing-Related Matters* (Jun. 25, 2020); *Order Postponing Virtual Hearing* (Jul. 14, 2020); *Order Rescheduling Virtual Hearing* (Aug. 3, 2020).

the disruption and delay caused by the COVID-19 pandemic. The Acting Register extended the Judges' deadline for issuing an initial Determination by up to 120 days, effectively making the deadline April 15, 2021. *See Public Notice Regarding Timing Provisions for Persons Affected by COVID-19*, U.S. COPYRIGHT OFFICE, <https://www.copyright.gov/coronavirus/> (last visited Jan. 11, 2021). The Register of Copyrights announced an additional 60-day extension on March 29, 2021, in the Copyright Office's NewsNet, Issue No. 889.

II. Context of the Current Proceeding: Prior Rate Determinations

Congress created the exclusive sound recordings digital performance copyright in 1995. *See* Digital Performance Right in Sound Recordings Act of 1995, Pub. L. No. 104-39, 109 Stat. 336 (1995). At the same time, Congress limited that performance right by granting noninteractive subscription services a statutory license to perform sound recordings by digital audio transmission. In 1998, Congress created the ephemeral recording license and further defined and limited the statutory license for digital performance of sound recordings. *See* Digital Millennium Copyright Act, Pub. L. 105-304, 112 Stat. 2860 (1998) (DMCA).

A. *Web I-Web III*

The Judges summarized the history of webcasting determinations from *Web I* through *Web III* in detail in their *Web IV* determination. *See Determination of Royalty Rates and Terms for Ephemeral Recording and Webcasting Digital Performance of Sound Recordings*, Final rule and order, 81 FR 26316, 26317-19 (May 2, 2016) (*Web IV*). The Judges hereby incorporate that discussion by reference into this Determination.

B. *Web IV* Determination and Appeals

The Judges commenced the *Web IV* proceeding in January 2014. SoundExchange and a *pro se* petitioner, George Johnson d/b/a GEO Music, represented the interests of

licensors. Seven licensees also participated in the hearing.⁶ The Judges approved two negotiated agreements, one for public broadcasters between SoundExchange and NPR and CPB, and the other for educational webcasters between SoundExchange and CBI.

The Judges concluded that “there is continued support in the marketplace for a different rate structure for commercial and noncommercial webcasters.” 81 FR 26316, 26320 (May 2016). The Judges therefore adopted separate rate structures for noncommercial and commercial webcasters. With respect to noncommercial webcasters, the Judges adopted a \$500 per station or channel fee for all transmissions by noncommercial webcasters up to a threshold of 159,140 aggregate tuning hours (ATH) for 2016 through 2020. For transmissions in excess of 159,140 ATH, the Judges set a rate of \$0.0017 per performance for 2016, which would be adjusted annually for changes to the CPI-U for the years 2017-2020. *Id.* at 26396.

The Judges also identified a distinction between two different types of copyright owners. Based on the record, the Judges observed that “in the marketplace, Services have agreed to pay higher rates to” major record labels (Majors) than to so-called independent labels (Indies). *Id.* at 26319. To gain clarity on whether the Judges could establish different rates based on differences among copyright owners, the Judges referred to the Register of Copyrights (Register) the novel question of whether the Act permits the Judges to differentiate based on types of licensors. The Register concluded that the Judges’ question did not meet the statutory criteria for referral and declined to answer it. *Id.* In the absence of an adequate record to support such differentiation, the Judges declined to adopt separate rates for Majors and Indies. *Id.*

⁶ The licensees were Harvard Radio Broadcasting, Inc., IBS, iHeartMedia, NAB, NRBNMLC, Pandora, and Sirius XM.

The Judges also addressed potential distinctions between groups of licensees. In particular, NAB argued that simulcasting is different from other forms of commercial webcasting and therefore simulcasters (*i.e.*, terrestrial radio stations that simulcast over-the-air broadcasts on the Internet) should pay a lower rate than other commercial webcasters. *Id.* at 26320. Based on the record in *Web IV*, however, the Judges concluded that NAB did not satisfy its burden to demonstrate that simulcasting differs in ways that would cause willing buyers and willing sellers to agree to a lower royalty rate in the hypothetical market. Therefore, the Judges did not adopt a different rate structure for simulcasters than that which applied to other commercial webcasters. *Id.*

SoundExchange and Pandora each proposed different greater-of rate structures employing a per-play rate and a percentage-of-revenue rate. All of the Services, other than Pandora, opposed such a two-pronged approach. The Judges concluded that the record did not support a greater-of rate structure in the rate period at issue in *Web IV*. *Id.* at 26323. Rather, the Judges found that the statutory rate should continue to be set on a per-play basis for commercial webcasters. *Id.* at 26325.

The Judges set two separate rates for commercial noninteractive webcasting. One applied to performances on subscription-based commercial noninteractive services. A separate rate applied to performances on nonsubscription services (*i.e.*, advertising supported services that are free to the listener). *Id.* at 26404. The Judges set each of the rates for 2016 (the first year of the five-year statutory license term) and then applied an inflation-based adjustment to the rates for the remaining years of the license. The Judges looked to separate benchmarks to establish the rates. For commercial noninteractive subscription services, the Judges used a benchmark developed by SoundExchange's expert, Dr. Rubinfeld, to which the Judges applied a 12% "steering" reduction to reflect a lack of competition in that particular segment of the market among the providers of the copyright works. The Judges also credited a rate established in an agreement between

Pandora and Merlin. Those two rates formed a zone of reasonableness, within which the Judges chose a per-performance rate of \$0.0022 for 2016. *Id.* at 26405.

With respect to the rate for commercial nonsubscription services, the Judges identified two usable benchmarks. One was based on a rate in an agreement between iHeart and Warner. The other was based on a rate from an agreement between Pandora and Merlin. *Id.* at 26405. The first represented an agreement between a service and a Major and the second between a service and Indies. The Judges used these rates to form a zone of reasonableness. The Judges selected a rate for 2016 of \$0.0017, which took into account a greater number of streams from Major sound recordings as opposed to the percentage of streams from Indie sound recordings. The rates for 2017 through 2020 would be adjusted to account for changes in the CPI. The rate for the Section 112 license would constitute 5% of the royalty services would pay for performances under the Section 114 license. *Id.* at 26406.

SoundExchange and George Johnson appealed the Judges' determination to the U.S. Court of Appeals for the D.C. Circuit. The court affirmed. *SoundExchange, Inc. v. Copyright Royalty Bd.*, 904 F.3d 41 (Sep. 18, 2018).

III. The Role of Effective Competition in Setting Webcasting Rates

A. The Concept of “Effectively Competitive” Rates

In *Web IV*, the Judges held that the Copyright Act either required them, or permitted them, in their discretion, “to set a rate that reflects a market that is *effectively competitive*.” *Web IV*, 81 FR at 2633 (emphasis added). The D.C. Circuit affirmed the Judges' conclusion that they had the discretionary authority “to determine rates through the lens of an effective-competition standard” (but held that the Judges were not required to do so). *SoundExchange*, 904 F.3d at 57.

More particularly, the D.C. Circuit found reasonable the Judges' construction of the statutory “willing seller/willing buyer-marketplace” standard as calling for the

establishment of rates that would have been set in an effectively competitive market. In that regard, the D.C. Circuit pointed to testimony and record evidence – referenced approvingly by the Judges – stating that “neither sellers nor buyers can be said to be ‘willing’ partners to an agreement if they are coerced to agree to a price through the exercise of overwhelming market power.” *SoundExchange*, 904 F.2d at 56 (quoting *Web IV*, 81 FR at 26331).

Additionally, the D.C. Circuit grounded its affirmance on its finding that the statutory willing buyer/willing seller-marketplace standard was inherently ambiguous. Because of this ambiguity, the D.C. Circuit held that the Judges had properly exercised their statutory duty by considering “the clear statutory purpose, applicable prior decisions, and the relevant legislative history.” *SoundExchange*, 904 F.3d at 55 (quoting *Web IV* at 26332). In particular, the D.C. Circuit took note of the Judges’ reliance on their own webcaster rate determination that had immediately preceded *Web IV*:

The [Judges] relied on one of [their] prior determinations in reasoning that, “[b]etween the extremes of a market with ‘metaphysically perfect competition’ and a monopoly (or collusive oligopoly) market devoid of competition there exists in the real world ... a mind-boggling array of different markets, all of which possess varying characteristics of a ‘competitive marketplace.’” [*Web IV*, 81 FR at 26333 (quoting *Web III Remand*, 79 FR at 23114 n.37)].

SoundExchange, 904 F.3d at 57.

In fact, the D.C. Circuit not only found that the Judges acted reasonably in this regard, but also that – when exercising their discretion – the Judges “*must* consider ‘competitive information’” contained in the hearing record, in order “to identify *the relevant characteristics of competitiveness* on which to base [their] determination of the statutory rates.” *SoundExchange*, 904 F.3d at 56-57 (emphasis added).

Consistent with the D.C. Circuit’s decision affirming *Web IV*, the Judges in this *Web V* proceeding again apply the standard that royalty rates for noninteractive services should be set at levels that reflect those that would be set in an effectively competitive

market. Further, the Judges note that no party in this proceeding challenges the application of this effective competition standard, although SoundExchange and the Services offer vastly different understandings of how the Judges should apply the standard in this case.

In *Web IV*, the Judges applied the concept of “effective competition” as a counterweight to the “complementary oligopoly” power of the Majors. *Web IV*, 81 FR at 26368 (identifying the “complementary oligopoly that exists among the Majors,” allowing them to “utilize their combined market power to prevent price competition among them”). Simply put, the Judges found that each Major is a “Must Have” licensor for noninteractive services (in the hypothetical unregulated market), meaning that each noninteractive service “must have” a license for the entire repertoires of Sony, Universal and Warner, in order to remain in business. Also, because the *interactive* market was proffered as a benchmark market in *Web IV* (as in the present proceeding), the Judges performed the same inquiry for that market, concluding that interactive licensees likewise “must have” access to the repertoires of each Major in order to survive commercially. *Web IV*, 81 FR at 26340, 26342. From a more technical economic viewpoint, the “Must Have” status of the three Majors rendered each a “complementary oligopolist.”⁷ As explained in *Web IV*, this status allows each Major to wield the individual economic power of a monopolist, but the exercise of that power leads to royalty rates that are even greater than those that would be set by a single monopolist. Specifically, the Judges held:

‘[I]f the repertoires of all [Majors] were each required by webcasters (*i.e.*, if the repertoires were necessary complements) ... each [Major] would have

⁷ “Complementary oligopolists” supply products or, as here, offer licenses, for access to products, that are “perfect complements,” meaning that the products or licenses they offer are essential, *i.e.*, “Must Haves,” for a buyer/licensee in order to operate its business. Such products/licenses are known in economics as “Cournot Complements.” *See Web IV*, 81 FR at 26342-43.

an incentive to charge a monopoly price to maximize its profits ... constitut[ing] *higher monopoly costs* ... paid by webcasters to each of the [Majors].’ ... The Judges in this determination adopt this economic reasoning and will not allow such complementary oligopoly power to be incorporated into the statutory rate.

Web IV, 81 FR at 26368 & n.142 (*quoting Web III Remand*, 79 FR at 23114); *see also Web IV*, 81 FR at 26342-43 (summarizing corroborating economic expert testimony as (i) stating that the complementary oligopoly structure is “*even worse than a market controlled by a single monopoly supplier* ... [as] first identified by Antoine Cournot in 1838”; and (ii) explaining that Universal had argued to the Department of Justice that its merger with EMI “would lead to lower prices because it would remove the Cournot Complements pricing effect” between the merging entities.).

In *Web IV*, the dispute regarding the “effective competition” standard focused essentially on the absence of *horizontal price competition between and among the Majors* – and whether such horizontal competition could be generated by noninteractive services in the *hypothetical (i.e., unregulated)* market.⁸ Based on the record in that proceeding, the Judges determined that the Services had successfully demonstrated how effectively competitive rates had been set, (*i.e., via steering, discussed infra*) even in the face of a complementary oligopoly.⁹

⁸ The section 114 statutory rate supplants an unregulated market rate, so the Judges must ascertain the rates that would have been set in such a *hypothetical* market. *See Web IV*, 81 FR at 26316, 26333. In *Web IV*, though, in addition to receiving evidence regarding the *hypothetical* market, the Judges were presented with *actual* market evidence of effectively competitive rates from the noninteractive market. *Id.* at 26343 (“[T]he Judges are not left with mere hypotheticals Rather, the Judges were presented with hard and persuasive evidence that ... reduced royalty rates in the noninteractive market and would do so in the hypothetical market as well.”).

⁹ The more particular issue was whether noninteractive services could foment such horizontal price competition among record companies through the services’ expressed intent to “steer” their algorithmically

The foregoing findings regarding the “Must Have” status of the Majors in the *interactive* benchmark market are not challenged in this proceeding. However, SoundExchange argues that, unlike in the *Web IV* period, the benchmark interactive market now generates effectively competitive rates, because the present record demonstrates that Spotify has gained licensee-side power sufficient to offset, in whole or in part, the Majors’ “Must Have” status. SoundExchange’s Second Corrected Proposed Findings of Fact and Conclusions of Law ¶ 89 *et seq.* (and record citations therein) (SX PFFCL). The Services dispute the assertion that the record shows Spotify to have acquired such power or that the interactive market has otherwise become effectively competitive. Services’ Joint Proposed Findings of Fact and Conclusions of Law ¶ 62 *et seq.* (Services PFFCL). (This issue is discussed in detail *infra*, section III.B.).¹⁰

Thus, the present record raises a new question: Have there have been changes in bargaining power between the Majors and Spotify in the interactive benchmark market such that the royalty rates in their agreements are consonant with the “effectively competitive” standard?

In order to address this new question, the Judges find it first necessary to consider the concept of “effective competition” in a context dictated by the present record, one that did not arise in *Web IV*. To put this analysis in proper economic context, it is helpful and, indeed, necessary, to begin by identifying the aspects of the “effective competition”

or humanly curated plays toward those licensed by Majors who agree to royalty rates lower than those of their competitors. *Web IV*, 81 FR at 26348 (“[T]he ability of noninteractive services to steer away from higher priced recordings and toward lower priced recordings (or threaten to do so) serves as a buffer against the supranormal pricing that arises from the impact of complementary oligopoly pricing”).

¹⁰ However, the Services dispute the assertion that all three Majors would be “Must Have” licensors in the hypothetical *noninteractive* market. Services PFFCL ¶ 195 *et seq.* That issue is discussed *infra*, section IV.C.2.b in the Judges’ consideration of Pandora’s “Label Suppression Experiments.”

standard that were addressed and determined in *Web IV*. In summary, those points are the following:

1. The Majors possess “complementary oligopoly power” in the actual (unregulated) interactive market and in the hypothetical (unregulated) noninteractive market that “thwart[s] price competition and [is] inconsistent with an ‘effectively competitive market’” *Web IV*, 81 FR at 26335.
2. Because there are a “mind-boggling” number of markets with various competitive characteristics, there exists a range of rates that may satisfy the “effectively competitive” standard – between the statutorily-created *de facto* zero rate for terrestrial sound recordings and the complementary oligopoly rate generated by the Majors’ power as complementary oligopolists – each of which can be seen as a “bookend” for the range of potential rates. *Web IV*, 81 FR at 26334.¹¹
3. The “essence of a competitive standard is that it suggests a continuum and differences in degree rather than in kind,” which dovetails with the Judges’ statutory charge to “weigh competitive information” in order to “decide whether the rates proposed adequately provide for an effective level of competition.” *Web IV*, 81 FR at 26334.¹²

¹¹ To borrow from Tolstoy, perfectly competitive and perfectly monopolist markets all gravitate toward well-understood equilibria in the same way, but oligopolistic markets move in different ways.

¹² Economists have acknowledged the pragmatic nature of applying the “effective competition” standard. *See, e.g.*, Alfred E. Kahn, *Antitrust Policy*, 67 HARV. L. REV., 28, 35, (1953) (“[T]here exists no generally accepted economic yardstick appropriate to ... determine what degree [of monopoly power] is compatible with [effective] competition.”); J. Markham, *An Alternative Approach to the Concept of Workable Competition* 349, 361 (1950) (The concepts of “market competition are essentially pragmatic”).

4. When the hearing record provides *actual evidence* allowing the Judges to determine whether a rate is effectively competitive, that evidence and the adjudicatory process vitiate the theoretical absence of an *a priori* “bright line” to distinguish effectively competitive and noncompetitive rates. *Web IV*. 81 FR at 26343.

In *Web IV*, the evidence demonstrated only one potential method for the amelioration of the ability of the Majors, as complementary oligopolists, to set noncompetitive rates. Specifically, Pandora and iHeart introduced evidence of agreements with Merlin and Warner, respectively, that incorporated “steering” into those agreements. “Steering” in this context means the presence of contract provisions by which a licensee will increase the number of plays of the counterparty record company above its historic market share, in exchange for the record company’s agreement to accept a lower royalty rate than other record companies. *Web IV*, 81 FR at 2366 (“The Judges find that steering in the hypothetical noninteractive market would serve to mitigate the effect of complementary oligopoly ... and therefore move the market toward effective, or workable, competition” together with “the ever-present ‘threat’ that competing [licensors] will undercut each other in order to [license] more”).

But *Web IV* does not consider in detail whether evidence of any *other economic factors* could also serve to offset or ameliorate the complementary oligopoly power present on the licensor/record company supply-side of the market. And further, the Judges never intimated – let alone determined – that steering was the *sole* method by which the complementary oligopoly power on the licensor side could be ameliorated.¹³

¹³ In fact, *Web IV* makes clear that the Judges found the injection of steering into the market (actual or hypothetical) could be “*sufficient*” to ameliorate the anticompetitive impact of complementary oligopoly power – not that an injection of steering was *necessary* to do so. See *Web IV*, 81 FR at 26367-68; see also *id.* at 26369 (Professor Shapiro noting that steering is only “an example of price competition at work.”).

Indeed, the *Web IV* Determination clearly explains that the steering adjustment is not a *sui generis* device for adapting a benchmark rate, but rather “is of a class with any other adjustments necessary to harmonize the benchmark rate with the statutory requisites.” *Web IV*, 81 FR at 26368.¹⁴

Web IV also must be understood as limited by the fact that the parties implicitly agreed (given the facts of that case) to apply a particular conception of “competition” – “price competition.” In fact, although the parties and the Judges discussed extensively the meaning of “*effective* competition,” they intentionally did not provide a rigid definition for the concept of “competition.” This absence is unsurprising because the only form of competition at issue in *Web IV* was price competition – a standard neoclassical variant. *Web IV*, 81 FR at 26366 (“The Judges find that steering in the hypothetical noninteractive market would serve to mitigate the effect of complementary oligopoly on the prices paid by the noninteractive services and therefore move the market toward effective, or workable, competition. Steering is synonymous with *price competition* in this market”) (emphasis added). But the Judges did not have cause to examine in any detail whether, beyond price competition, it was appropriate to consider other dimensions of competition, of which there are several. *See generally* Donald J.

¹⁴ In *Web IV*, the Judges did touch upon the potential for countervailing licensee power as a potential mitigating or offsetting factor. SoundExchange asserted that Pandora had significant (monopsony) market power in its own right in the noninteractive market that generated rates below effectively competitive rates in its benchmark agreement with Merlin. But the Judges rejected SoundExchange’s argument, finding – in reliance on an analysis presented by Pandora’s economic expert witness, Professor Shapiro – that “Pandora’s share of the Merlin Labels’ [overall] revenues is far short of the level that would be necessary for Pandora to have undue market power in its negotiations with Merlin.” *Web IV*, 81 FR at 26371. Implicitly, the Judges there indicated that, had Pandora possessed sufficient market power, that fact may have weighed in the Judges’ calculus in reducing the effective competition adjustment, thereby increasing the effectively competitive statutory rate.

Harris, *On the Classical Theory of Competition*, 12 CAMBRIDGE J. OF ECON., 139, 141, 146 (1988) (contrasting the “relative tranquility [of] the *neoclassical conception of competition* ... formalized in a vast array of modern textbooks” with “a structure of oligopolistic firms *in which price competition is simply one component* ... of a broader process of *strategic rivalry* among leading firms [and] other possible behavioural rules on price formation.”) (emphasis added).

So, although the importance of effective price competition cannot be disputed, the Judges must consider whether, if such competition is lacking, other forms of market behavior either substitute for price competition or otherwise generate prices consonant with those that would be established through price competition in an effectively competitive market. In fact, as discussed below, the Judges have engaged in such analyses in prior cases.

The first case in which the Judges considered other economic dimensions beyond price competition was the *SDARS III* proceeding. In that case, the Judges again addressed the complementary oligopoly power of the Majors, albeit in connection with a different and now superseded statutory rate-setting standard. *SDARS III*, 83 FR at 65320 n.82.¹⁵ There, the Judges noted that the licensor-side complementary oligopoly power could be ameliorated by the “*countervailing power*” of a licensee (Sirius XM in that case) that possessed a large share of the downstream market at issue (a monopoly share of the satellite radio market in that case). *SDARS III*, 83 FR at 65238.¹⁶

¹⁵ The superseded statutory standard was set forth in 17 U.S.C. 801(b)(1). Despite the different standard, the Judges applied the same hypothetical market approach in *SDARS III*, before considering whether that hypothetical market rate should be adjusted to account for factors set forth in the now superseded statute. *SDARS III*, 83 FR. at 65237, 65253.

¹⁶ That countervailing power, the Judges noted, existed if the market in which the licensee operated is not subject to meaningful potential substitution from listening via another form of music delivery. *Id.*

And, in the next rate-setting case, *Phonorecords III*, the Judges (in the majority *and* in the dissent) found that the licensors — owners of the copyrights for musical works — possessed complementary oligopoly power. The majority Determination found that this noncompetitive effect could be ameliorated — not only by steering or another form of price competition —but by the application of economic game theoretic modeling (specifically, the Shapley Value approach) that economic experts testified would have such an effect. *Phonorecords III*, 84 FR at 1947, 1950 (“The Judges look to the Shapley Analyses ... as one means of deriving a reasonable royalty rate (or range of reasonable royalty rates) The Judges ... find that the Shapley Analysis ... eliminates the ‘holdout’ problem that would otherwise cause a rate to be unreasonable, in that it would fail to reflect effective (or workable) competition.”).¹⁷

The *Phonorecords III Dissent*, although certainly not discounting the value of the Shapley Value approach, asserted instead that the complementary oligopoly power could be better ameliorated by adopting the benchmark proposed by the interactive streaming service-licensees, which was essentially the *Phonorecords II* rate structure, *i.e.*, a benchmark based on the rates in effect in the prior rate period that had been adopted in a settlement between industrywide trade associations, the NMPA and DiMA, representing licensors and licensees, respectively. *Phonorecords III*, 84 FR at 1993 (dissent) (“settlement agreements tend to eliminate complementary oligopoly inefficiencies, and provide guidance as to an effectively competitive rate.”). Thus, once again, a Copyright Royalty Judge applied a factor — countervailing power — other than the presence of price competition, to determine an effectively competitive rate.

¹⁷ Although the D.C. Circuit vacated and remanded the *Phonorecord III Determination*, the general point stands: The Judges consider factors and methods other than price competition (via steering or otherwise) to determine whether a rate is “effectively competitive” and, more specifically, whether such other factors or methods counterbalance the rate inflation caused by the complementary oligopoly effect.

In this regard, it is important to note that the concepts of “effective competition” and “countervailing power” are not mutually exclusive, but are better understood as *complementary*. Professor John Kenneth Galbraith, who developed the concept of “countervailing power,” defined it as follows:

[W]ith the widespread disappearance of competition in its classic form ... it was easy to suppose that since competition had disappeared, all effective restraint on private power had disappeared [However,] [i]n fact, new restraints on private power did appear to replace competition [T]hey appeared not on the same side of the market but on the opposite side, not with competitors but with customers or suppliers ... *countervailing power*.

JOHN KENNETH GALBRAITH, *AMERICAN CAPITALISM: THE CONCEPT OF COUNTERVAILING POWER* 111 (1952).

In *Web IV*, the Judges recognized the economist J.M. Clark as the individual who introduced into microeconomics analysis the concept of effective competition, which he originally described as “workable competition.” *Web IV*, 81 FR at 26341 n.96 (citing J. M. Clark, *Toward a Concept of Workable Competition*, 30 AM. ECON. REV. 241 (1940)). Two decades hence, Professor Clark wrote a book that served, in his words, as an “elaboration of [the] line of inquiry” dating from his seminal 1940 article. JOHN MAURICE CLARK, *COMPETITION AS A DYNAMIC PROCESS* at ix (1961). In that volume, Professor Clark took note of the compatibility between the concept of “countervailing power” and his own concept of workable/effective competition. CLARK, *supra* at 5 (noting approvingly Professor Galbraith’s view that, if competition is found wanting, “countervailing power” serves as a “rough substitute” that can “deprive monopoly of its arbitrary power”).¹⁸

¹⁸ In his 1961 treatise, Professor Clark expressly “shift[s] . . . from ‘workable’ to ‘effective competition’”, because “[t]he theory of effective competition is dynamic theory,” going beyond “the analysis of static equilibrium” to “bring[] in the ... *interplay between aggressive and defensive forms of competition*” *Id.* at ix. (emphasis added).

Likewise, in *American Capitalism*, Professor Galbraith expressly acknowledges the interplay between Professor Clark's conception of effective/workable competition and the principle of "countervailing power":

There remains the possibility that within the structure of the market shared by a few firms there are practical restraints on economic power – that there is an attenuated but still *workable competition which minimizes the scope for exercise of private market power* This line of argument has emphasized results The notion of workable competition takes cognizance of the ... point that over-all consequences, while in theory are deplorable, are often in real life quite agreeable [W]hat is unworkable in principle becomes workable in practice ... because *the active restraint [on the exercise of market power] is provided not by competitors but from the other side of the market by strong buyers*.

GALBRAITH, *supra* at 57-58, 112 (emphasis added); *see also id.* 158 n.912 (noting the "originality of Professor J.M. Clark" and crediting his 1940 article for the development of the concept of workable competition).¹⁹

¹⁹ Despite Professor Galbraith's well-known progressive leanings, his concept of "countervailing power" as a means for more competitively dividing profits between input oligopolists and oligopsonists has been well-received by ardent free market economists as well, including a Nobel Prize winner. *See, e.g.,* George J. Stigler, *The Economist Plays with Blocs*, 44 AM. ECON. REV., no.2, 7, 9, 13-14 (1954) (papers and proceedings) (agreeing that Galbraith's concept of "countervailing power" describes a context in which "a monopsonist or a set of oligopsonists arises and shares the gains of a previously unhampered monopolist or set of oligopolists," because "[i]t is true that as countervailers they might share monopoly profits"). However, Professor Stigler disagreed vehemently with the notion that the bilateral oligopolies formed through the exercise of countervailing power "reduce prices to consumers" or "should in general eliminate, and not merely redistribute, monopoly gains." *Id.* at 9, 13. But such downstream effects are irrelevant to the Judges' statutory task of setting an effectively competitive royalty rate in the upstream market. Moreover, Professor Stigler cautioned that the presence of "countervailing power" in a market will not necessarily "place groups on a basis of *equality* with respect to one another" *Id.* at 14 (emphasis added). Accordingly, even if Spotify has acquired some additional bargaining power, *that does not mean that its bargaining power is equal* to the complementary oligopoly of the Majors. That is, any new

In sum, the inclusion of the concepts of price competition and countervailing power into microeconomic analysis – as already applied by the Judges in several determinations – makes it clear that the Judges must consider record evidence regarding both of these economic concepts in order to fulfill their statutory mandate to establish rates that would be set between willing sellers and willing buyers in the marketplace. The Judges discuss and apply both of these economic concepts below.

B. Evaluation of Arguments Concerning Effective Competition

1. SoundExchange’s Claim that Spotify has Downstream Pricing Power that Mitigates or Offsets the Majors’ Complementary Oligopoly Power

SoundExchange asserts several bases for its claim that the complementary oligopoly power of the Majors has been mitigated in part, or offset in full, by the increase in Spotify’s market power, which has manifested in the latter’s ability to [REDACTED]. More particularly, in the agreements between Spotify and the Majors that immediately preceded their 2017 agreements,²⁰ the contract rate for [REDACTED]. In all three subsequent 2017 agreements between Spotify and the Majors, [REDACTED]. Trial Ex. 5609 ¶ 24 (WDT of Aaron Harrison) (Harrison WDT); Trial Ex. 5611 ¶ 10 (WDT of Reni Adadevoh) (Adadevoh WDT); Trial Ex. 5613 ¶ 31 (WDT of Mark Piibe) (Piibe WDT) ([REDACTED]).

SoundExchange identifies the following three interrelated sources for Spotify’s alleged increase in pricing power in 2017 that generated this [REDACTED]:

1. Spotify now generates [REDACTED]. SX PFFCL ¶ 306 *et seq.*

bargaining power enjoyed by Spotify could mitigate the Majors’ complementary oligopoly power but not necessarily offset it in full.

²⁰ The 2017 agreements were the most recent agreements available for inclusion in the record in this *Web V* proceeding.

2. Spotify can now [REDACTED]. SX PFFCL ¶ 311 *et seq.*
3. Spotify now has the ability to steer a significant number of plays on Spotify-curated playlists. SX PFFCL ¶ 346 *et seq.*

The Judges examine each of these assertions seriatim below.

**a. Has Spotify's Increased Share of each Major's Revenue provided
Spotify with Leverage to Obtain [REDACTED]?**

SoundExchange asserts that – between 2014 and 2017 – there has been explosive growth in the subscription on-demand format. More specifically, SoundExchange notes that, whereas in 2013, U.S. retail revenue from on-demand services was approximately \$0.9 billion, by 2016, this revenue total had increased to approximately \$2.8 billion and, by 2017, to approximately \$4.2 billion. This growth has continued, with 2018 retail revenue from on-demand services greater than \$5.4 billion, and, by 2019, reaching \$6.8 billion. *See* Trial Ex. 5604 app. 2 (WDT of Catherine Tucker) (Tucker WDT); Trial Ex. 4115 at 3.²¹

Accordingly, SoundExchange maintains that the Majors have now become increasingly reliant on income generated by all the interactive services. Because of this changed circumstance, SoundExchange avers that the balance of pricing power as between the Majors and Spotify has changed, with the latter now in a position to bargain more aggressively for favorable rates and terms. *See* Trial Ex. 5602 ¶¶ 119-131 (WDT of Jon Orszag) (Orszag WDT).

²¹ The Services do not dispute the fact of significant growth in the subscription on-demand market over this period, but they assert that Professor Tucker's data appear to include ad-supported on-demand revenue as well as subscription on-demand revenue. *Compare* SX PFFCL ¶ 306, *with* Tucker WDT app. 2. This specific potential discrepancy does not alter the substance of the parties' dispute nor the Judges' analysis of this issue.

The Services assert that this is merely a re-tread of the SoundExchange argument the Judges rejected in *SDARS III*. Although the Services dispute neither the growth in music industry revenue nor the growth of interactive streaming *industry* revenue from 2014 through 2017,²² they assert that the revenue data does not support Sound Exchange’s argument that *a single service’s growth – here, Spotify’s* revenue growth – supports the assertion that the Majors’ complementary oligopoly power has been compromised. More specifically, the Services maintain that the important metric is *the percentage of the music industry’s total revenue* generated by Spotify. In this regard, the Services take note that Spotify accounted for [REDACTED] [REDACTED] of the Majors’ total U.S. revenue in 2017, and only [REDACTED] in 2018. Trial Ex. 1105 ¶ 64 (AWRT of Steven Peterson) (Peterson WRT); Trial Ex. 4107 at 10 & n.17 (WRT of Carl Shapiro) (Shapiro WRT). Additionally, the Services’ economic expert witnesses reject the idea that the Majors’ complementary oligopoly power vis-à-vis Spotify has been compromised because of the latter’s contribution to the Majors’ revenue stream. These witnesses further aver that, because Spotify and its on-demand service competitors offer essentially the same service at the same downstream subscription price, if one Major’s repertoire was unavailable on Spotify, subscribers would turn to its competitors, thus abandoning Spotify in the process. 8/25/20 Tr. 3713-14 (Peterson); 8/19/20 Tr. 2859 (Shapiro).

The Judges agree with the Services reasoning and conclusion, finding that the increase in revenues from the *entire interactive services sector* cannot support SoundExchange’s argument that *Spotify’s* pricing power vis-à-vis the Majors has

²² “The Services agree that streaming accounts for a larger percentage of the overall revenue for recorded music, however the industry’s total revenue has increased substantially since 2013.” Services RPFCL ¶ 308.

strengthened.²³ The Judges find that *Spotify's relative pricing power* must be evaluated in the context of *Spotify's particular economic position*. The Judges find nothing in the record to demonstrate that Spotify provides an on-demand service that is so unique to listeners as to imbue it with greater bargaining leverage.²⁴ More particularly, even

²³ The Services are correct in noting that the Judges rejected the same argument when asserted by SoundExchange in a prior proceeding. *See SDARS III*, 83 FR at 65238, 65245. However, each proceeding considers the facts as presented in the record of that pending proceeding, so the Judges are not constrained here by the factual record as presented in *SDARS III*.

²⁴ In the language of economics, Spotify and the other on-demand services – such as Apple Music, Google, Amazon, and others with a smaller market footprint – may provide somewhat *differentiated* on-demand experiences *inter se*, but nothing in the record suggests that whatever differences exist make them anything other than mere “monopolistic competitors,” rather than buyers/licensees with enhanced pricing power. *See generally* ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS 451 (8th ed. 2012) (In a “monopolistically competitive market ... [f]irms compete by selling differentiated products that are highly substitutable for one another.... [T]he cross-price elasticities of demand are large but not infinite ... [t]here is free entry and exit ... [and] [i]n long-run equilibrium ... the firm earns zero profit even though it has monopoly power [over its own brand].”). Further, the essential products offered by interactive services, as SoundExchange’s industry witnesses all tout, are their sound recording repertoires, which makes a listener’s selection of any particular streaming service of secondary concern compared to the ability to access all the music. *See* Harrison WDT ¶ 5 (identifying, as examples, 23 Universal artists who are “some of the best known and most popular recording artists in the world”); Piibe WDT ¶¶ 6-7 (listing, as examples, Sony’s own 23 artists who are “superstars” and “legendary recording artists”); Adadevoh WDT ¶ 3 (listing, as examples, 10 Warner artists who are among “today’s most popular artists, within a roster of “some of the most celebrated artists in recorded music history”). These artists and their recordings are not available only on Spotify.

The chronic lack of profits and essentially identical downstream subscription prices persuade the Judges that the Services are correct that the on-demand streaming services lack of market power downstream and an absence of pricing power upstream. Further, the meteoric growth of Apple Music in the streaming

acknowledging that, *ceteris paribus*, a Major would prefer to avoid the loss of Spotify's [REDACTED] to overall music revenues, the substitutability of the on-demand subscription services indicates to the Judges that the potential loss of *Spotify's* royalty payments to a Major would be quickly offset in the form of increased royalties from Spotify's *competitors*, as subscribers substituted alternative on-demand subscription services that offered the music licensed by all the record companies. Thus, there is no basis for the Judges to conclude that a Major would be willing to capitulate to Spotify by [REDACTED].

To make this argument from a different perspective, SoundExchange also looks at Spotify's U.S. revenue through the narrower prism of total U.S. subscription interactive revenues – noting that Spotify was responsible in 2016 and 2017 for a more considerable portion – almost [REDACTED]% of such domestic royalties. Orszag WDT ¶124, tbl.11. However, the Services aver that this [REDACTED]% figure needs to be placed in an appropriate temporal context. Specifically, they note that Spotify's share of U.S. gross subscription interactive revenues has actually fallen from 2015, when it was [REDACTED]% of the total, to 2018, when it accounted for [REDACTED]% of the total. *See* Orszag WDT ¶ 124, tbl.10.

Because the specific issue under consideration is the alleged *change* in Spotify's pricing power since the execution of the parties' 2013 agreements, the Judges find that the *dynamic* changes in subscription revenue shares during the relevant period is a more meaningful metric than the static [REDACTED]%-[REDACTED]% market share measure. Because Spotify's share of domestic revenues has diminished [REDACTED] since 2015 – *according to Mr. Orszag's own written testimony* – there is no basis to

market and the recent strong growth of Amazon and Google in the on-demand sector, show that the on-demand streaming market has characteristics of a competitive market. *See* Orszag WDT tbl.4.

support SoundExchange's claim that the Majors had become *more* dependent upon Spotify's revenue stream over this period. Moreover, because the decrease in Spotify's share of domestic on-demand subscription revenue coincided with the rapid growth of Apple Music's entry into the market, these data further confirm the substitutability of interactive services among the listening public, further diminishing the Majors' dependence on any single interactive service.

Placing Spotify's royalty revenues in the context of two Majors' internal contract renewal discussions, SoundExchange relies on the testimony of two witnesses, for Sony and Warner respectively.²⁵ First, according to the Sony witness, the [REDACTED] 9/2/20 Tr. 5228 (Piibe); Trial Ex. 5467 at 1. Moreover, Sony believed that Spotify was [REDACTED]. 9/2/20 Tr. 5368 (Piibe).

Second, Warner also emphasized the impact of [REDACTED]. In its internal documents discussing negotiations with Spotify, Warner executives expressed the importance of [REDACTED], with one executive stating: "[REDACTED]" Trial Ex. 4025 at 1. However, the Services point out that, in the very same document, Warner executives were also emphasizing that [REDACTED] and that Warner [REDACTED] Trial Ex. 4025 at 1.²⁶

Moreover, although the internal [REDACTED] deliberations summarized in Trial Ex. 4025 reference the [REDACTED], the recitation of that latter point is not economically relevant, let alone dispositive. Internal business documents that reflect information such as historical revenue or other accounting data but ignore crucial economic information regarding, for example, the fluidity of market shares, the elasticity

²⁵ The Judges discuss the separate negotiations between Spotify and the three Majors in detail *infra*.

²⁶ As the Judges *discuss* in greater detail *infra*, the interest Warner (or either of the other Majors) had in [REDACTED] is the only economically credible rationale for [REDACTED].

of market demand, and the absence of barriers to entry, are not only lacking in economic relevancy, they obscure the identification of relevant economic evidence. *See* Geoffrey A. Manne & E. Marcellus Williamson, *Hot Docs vs. Cold Economics: The Use and Misuse of Business Documents in Antitrust Enforcement and Adjudication*, 47 ARIZ. L. REV. 654 (2005) (noting in the analogous area of antitrust law, “[r]eliance on accounting data, market characterizations, and statements of intent by economic actors threatens to undermine the economic foundations of antitrust jurisprudence, and thus the purpose of the antitrust laws.”). This caution extends from comments made by negotiators in the trenches up to discussions in corporate boardrooms. *See William Inglis & Sons Baking Co. v. ITT Cont’l Baking Co.*, 668 F.2d 1014, 1028 (9th Cir. 1982) (discounting the probative value of “boardroom ruminations” in antitrust cases). In fact, Mr. Orszag is in agreement with regard to the primacy of economic testimonial analysis over such other evidence. 8/11/20 Tr. 1338 (Orszag) (“It’s well understood in competition economics ... that ... *economic analysis should play a dominant role*” relative to the role of statements of the commercial actors and internal company documents.) (emphasis added).²⁷

In sum, the Judges find that Spotify’s share of the Majors’ downstream revenue does not explain why [REDACTED].

²⁷ In *Web IV*, the Judges found that the existence of negotiations between Must Have record companies and interactive services did not prove that the latter had pricing power, because expert economic testimony explained that even monopolists will negotiate in order to estimate their counterparties’ willingness-to-pay. Thus, the Judges held: “[T]he mere existence of ... negotiations is *uninformative* as to whether the rates negotiated between the interactive services and the Majors are competitive.” *Web IV*, 81 FR at 26343. Thus, evidence of negotiations must be examined contextually – on a case-by-case basis – to ascertain whether that evidence in fact reflects an effectively competitive environment.

b. Can Spotify [REDACTED]?

SoundExchange asserts that the Majors could not reasonably [REDACTED], because [REDACTED]. SX PFFCL p. 105 *et seq.* First, Sony’s testifying witness, Mr. Piibe, explained that the [REDACTED]. 9/2/20 Tr. 5229-30 (Piibe). Further, according to a Warner analysis, [REDACTED]. Trial Ex. 5077. *See also* Harrison WDT ¶ 35 (“It would take time to [REDACTED] ...”). From this testimony and evidence, SoundExchange concludes that “[REDACTED] ...” SX PFFCL ¶ 317 (and record citation therein).

The Services emphasize in response that this argument again ignores the fundamental bargaining point: that because [REDACTED]. Services' Corrected Reply to SoundExchange's Proposed Findings of Fact and Conclusions of Law ¶ 311 (and record citations therein) (Services RPPFCL). To that end, the Services point to the testimony of a [REDACTED] witness, who said that [REDACTED]. 9/9/20 Tr. 5932 ([REDACTED]). *See also* 9/2/20 Tr. 5424-25 ([REDACTED]) (noting that if [REDACTED]).

With regard to the distinction between short-run and long-run effects, Professor Shapiro contextualizes the issue in an economic manner. Shapiro WRT at 7 n.16 (“the economics of bargaining teaches that bargaining power depends on the long-run impact on both parties of failing to reach an agreement, with future impacts suitably discounted as are all cash flows.”). That is, he considers the problem as a weighing of present discounted values to Spotify, on the one hand, and to a Major, on the other, over a one-year period,²⁸ of a license negotiation impasse that leaves Spotify without the Must Have

²⁸ It was agreed that [REDACTED]. Peterson WRT ¶ 66; 9/3/20 Tr. 5928-30 ([REDACTED]); *see also* 8/11/20 Tr. 1293-94 (Orszag) (“obviously there’s a longer-term effect that would occur that would be adverse to Spotify”); Leonard WRT ¶ 77 (“[A] label would have a greater ability to wait out the impasse,

Major and, reciprocally, leaves the Major without the Spotify platform. The Judges find

his analysis highly persuasive, and thus quote it at some length below:

[C]onsider as an example the negotiations between Spotify and Sony. Sony is “must-have” for Spotify (as Mr. Orszag concedes), so if Spotify fails to sign a license with Sony, Spotify’s interactive service will decline, fail to be commercially viable, and be forced to close down. Unquestionably, that makes an impasse very costly for Spotify, so Sony has a great deal of bargaining power in its negotiations with Spotify.

Mr. Orszag[’s] claim[] that Spotify has comparable pricing power comparable to that of a “must-have” service for Sony ... does not withstand scrutiny. If Sony does not sign a license with Spotify, so Spotify is forced to stop offering Sony tracks, Sony will immediately suffer a loss of royalty income from Spotify.... According to Table 13 in the Orszag WDT, Sony received [REDACTED]% of its total revenue from Spotify in 2017.

Mr. Orszag provides no explanation of why Sony losing up to [REDACTED]% of its revenue from recorded music is comparable, in terms of impact and thus bargaining power, to Spotify having to shut down its service altogether. Moreover, the [REDACTED]% figure for Spotify’s share of Sony’s revenue in 2017 is far too high as a measure of the revenue that Sony would have lost, had Sony music no longer been available on Spotify. Crucially, the [REDACTED]% figure represents the *immediate* impact on Sony, before any Spotify subscribers respond to the absence of Sony music.

Quite soon, Sony’s loss of income would be much smaller. As emphasized repeatedly by SoundExchange—indeed as a foundational pillar of its entire case here—a “must-have” record company bears a substantial opportunity cost of licensing to a music service because without its music listeners to that service will shift their listening time to other forms of music listening. By definition, that implies that when Sony does not license to Spotify, Sony will gain substantial revenue from other licensees and other forms of listening. As a matter of arithmetic, that means that Sony would lose less than [REDACTED]% of its revenue.

As an illustrative example, suppose that Spotify would shut down after one year, due to its lack of Sony’s “must-have” repertoire, and suppose that all of the former Spotify subscribers would replace their Spotify subscriptions with subscriptions to other interactive services that pay royalties comparable to those paid by Spotify. In that case, Sony would be made entirely whole after the first year. In that situation, Spotify would have very little pricing power in its negotiations with Sony, far less than Sony’s power as a “must-have” record company.

given that it would continue to receive royalties from other sources, whereas the service’s entire subscription revenues would potentially be at risk”).

Mr. Orszag and the label witnesses on which he relies emphasize the *short-term* cost to a record company of not licensing to Spotify. However, economic theory tells us that the correct measure of the cost to Sony of not licensing to Spotify in a bargaining context is the *present discounted value* of the revenue that Sony would lose in total. The present discounted value includes short-term *and* long-term effects, weighting them appropriately given the time value of money.

This is a critical point in understanding relative bargaining power in the upstream interactive services market. The underlying idea is relatively simple and hopefully intuitive: when two parties are bargaining, their bargaining power does not just depend upon how costly an impasse would be for each of them over the first day or week, but rather upon how costly an impasse would be over time. Mr. Orszag's analysis is unreliable because he focuses excessively on the short-term cost to a major record company of not licensing to Spotify and fails to account for the long-term effects.

Shapiro WRT at 7-8 (emphasis added; footnotes omitted).

Applying an 8% annual discount factor – that Professor Shapiro found to be a reasonable cost of capital to use for generating present value – as well as other assumptions not challenged as unreasonable by SoundExchange – Professor Shapiro found that not licensing to Spotify would: (i) cause Sony to lose only [REDACTED]% of the present discounted value of its royalty income; and (ii) by [REDACTED] contrast, cause Spotify to lose approximately 95% of the present discounted value of its revenue and profits. Shapiro WRT at 9. Accordingly, Professor Shapiro concludes that “[c]learly, in this situation Sony would be in the driver’s seat in negotiating with Spotify.” Shapiro WRT at 9.

The only rejoinder by SoundExchange, through Mr. Orszag, is that the record reflects a [REDACTED] than the weighting reflected in a present value approach that did not incorporate this [REDACTED]. However, the record is barren of any analysis [REDACTED] The Judges find this alternative not credible. Moreover, even if the Majors did [REDACTED], they would surely recognize (and, indeed, do not dispute) that [REDACTED].

Indeed, the Services emphasize that the testimony of Majors’ witnesses regarding the impact of [REDACTED] was speculative and lacked support – particularly as it

related to [REDACTED]. *See* 9/2/20 Tr. 5388 (Piibe) ([REDACTED]); 9/3/20 Tr. 5731-32 (Harrison) (admitting that [REDACTED]).

Given the dearth of analysis in the record of the relative harms to Spotify and the Majors from a prolonged blackout, and the fact that such a consequence would spell Spotify's commercial demise, the Judges find that SoundExchange's assertion that [REDACTED], beggars belief.

The Services also seek to diminish the evidentiary value of Trial Ex. 5077, on which [REDACTED] relies. That document, the Services note, is a [REDACTED]. Moreover, the Services point out that this document [REDACTED]. Services RPPFCL ¶ 315 (and record citations therein).²⁹

In sum, the Judges find that SoundExchange's claim that the effect on a Major of its loss of the Spotify platform (*i.e.*, going dark on Spotify) has altered the power dynamic between Spotify and the Must Have Majors to be incomplete at best, and almost certainly incorrect. In order to demonstrate that the power complementary oligopolists bring to the market and thus to the bargaining table had been neutralized to any degree, [REDACTED] needed to do more than [REDACTED]. Because the context of this analysis is to ascertain relative negotiating power, SoundExchange needed to demonstrate that the economic impact to the Majors of going dark on Spotify would at least approximate the impact of such an event on Spotify. This SoundExchange decidedly did not do. Rather, the evidence is clear – and the economic logic of maximizing the present value of profits and minimizing the present value of losses is compelling – that a Major going dark on Spotify would work expeditiously to contain losses and entice Spotify

²⁹ The Services also note that the reference to a [REDACTED] reflects a situation that arose in Mexico and that there is no evidence or testimony to support [REDACTED] implication that this foreign event is representative of what would occur in the United States. *See* Trial Ex. 5077; Services RPPFCL ¶ 317.

subscribers to maximize their own self-interest by moving to an interactive service that continued to play that Major's music.

SoundExchange alternatively seeks to show that the Majors' bargaining power has been compromised vis-à-vis Spotify because Spotify [REDACTED]. SX PFFCL ¶¶ 318-327 (and record citations therein). In response, the Services note the absence of testimony from artists themselves regarding whether they might depart from a Major who failed to secure a license deal with Spotify. In fact, the Services point out that testimony upon which SoundExchange does rely – [REDACTED] – indicates [REDACTED] [REDACTED].” 9/2/20 Tr. 5426-27 (Jennifer Fowler). And, in terms of the legal and practicable ability of [REDACTED]. 9/9/20 Tr. 5952-54 (Sherwood); 9/3/20 Tr. 5738 (Harrison).

The Judges find compelling the absence of the testimony from any artists as to how they would react if the Major with which they had contracted lost the Spotify platform because of an impasse in licensing negotiations. In the absence of such testimony, the Judges put particular weight on the testimony, cited above, from [REDACTED] indicating that [REDACTED].

SoundExchange also suggests that a Major would suffer several miscellaneous injuries if it reached an impasse with Spotify that resulted in that Major going dark on the Spotify platform. First, the Major would [REDACTED]. *See generally* Trial Ex. 5017; SX PFFCL ¶ 328 (and record citations therein). However, the Judges agree with the Services that a Major's ongoing ability to obtain data from other interactive services would reduce the impact of such a data loss, especially as erstwhile Spotify subscribers – unhappy with the loss of a Major's repertoire – migrated to other on-demand services. Moreover, even the prospect of a short-term data loss is quite low, given the futility of a Spotify strategy of actually forcing a Must Have to go dark.

Another damage which SoundExchange posits derives from the testimony of a Universal executive who was concerned that a [REDACTED] could [REDACTED] Harrison WDT ¶ 35; 9/3/20 Tr. 5724 (Harrison). The Judges find this testimony to constitute mere speculation, and meritless speculation at that. The Judges find it bordering on the absurd to contemplate that a licensing impasse between a single service and a single Major [REDACTED]. Other interactive services that are already competing vigorously in the market stand at the ready to acquire Spotify's subscribers and, given the low barriers to entry for streaming services, the concept of contestable competition means that a new competitor could also enter and compete for a share of the market. *See* Shapiro WRT at 9.³⁰

Continuing with its speculation regarding miscellaneous harm, SoundExchange argues that, upon a licensing impasse with a Major, Spotify's subscribers would not abandon it because (i) subscribers pay monthly or yearly for their subscriptions, (ii) Spotify delivers well-customized recommendations, (iii) subscribers have invested time in building their music collection, (iv) subscribers who purchased Spotify as a part of a bundle may be less likely to cancel their subscription, and (v) subscribers might anticipate a quick resolution to the licensing dispute. SX PFFCL ¶¶ 339-343 (and record citations therein). The Judges agree though with the Services that these assertions are

³⁰ Further, Spotify's competitors (as well as aggrieved artists and social and mass media) would likely spread the word publicly regarding the music missing from Spotify in the event of a blackout of a Major, hastening the transition of Spotify customers to other interactive services. Ironically, as discussed *infra*, this is the very sort of accelerating demise that, according to SoundExchange (in convincingly criticizing Pandora's Label Suppression Experiments), would befall a noninteractive service that attempted to black-out a Major. If noninteractive ad-supported listeners – *who pay nothing out-of-pocket to listen to music curated by the service* – would switch away from the service if they became aware of the blackout of a Major, then, *a fortiori*, Spotify's interactive subscribers – *who do pay out-of-pocket to listen to music they demand* – would certainly switch away from Spotify if it likewise blacked-out a Major's entire repertoire.

little more than rank speculations. As the Services point out, because on-demand plays account for [REDACTED]% of Spotify listening hours, the idea that subscribers would tolerate the loss of any Majors' repertoire because of behavioral impediments is not only unexplored, it assumes a remarkable irrationality among subscribers with regard to their own tastes and preferences. Further, SoundExchange's assertion of this speculative *status quo outcome* is *180 degrees* from its immediately preceding speculative assertion that *the entire subscription concept and market would collapse* if a single Major went dark on Spotify. While there may be a *rational* argument why either outcome could occur, neither extreme is reasonable or based on record evidence. Moreover, it is not rational to posit that such a licensing disagreement would cause the industry both to remain in stasis and to disappear. Indeed, by making both arguments simultaneously without evidentiary support, SoundExchange seems willing to engage in the evidentiary equivalent of throwing spaghetti against the wall to see if any of it sticks.³¹

In sum, the Judges find insufficient evidence to support SoundExchange's argument that a Major going dark on Spotify would lead to a "parade of horrors" befalling that Major so substantial as to imbue in Spotify a market power sufficient to [REDACTED].

³¹ SoundExchange also posits that whatever injury would befall the domestic industry would also injure the global music market. SX PFFCL ¶¶ 337-338. However, this assertion is likewise devoid of evidentiary support, as there is no adequate record support that foreign agreements are affected by the existence, *vel non*, of licensing agreements in U.S. interactive markets. See Services RPFCL ¶ 338. As a general rule, the Judges have eschewed reliance on developments in foreign markets when the proofs are insufficient to demonstrate a posited connection between foreign and U.S. market that is relevant to these proceedings. *SDARS II*, 78 FR at 23058 (and precedent cited therein).

c. Does Spotify's *Technological* Ability to Steer Plays on Spotify-curated Playlists provide it with Pricing Power Sufficient to Mitigate or Offset the Majors' Complementary Oligopoly Power?

The bulk of Spotify's argument in support of its claim that Spotify has a pricing power commensurate with the overall bargaining power of the Majors is based on Spotify's *technological* ability to steer plays of sound recordings toward or against a record company. This emphasis on steering is unsurprising, because in *Web IV* the Judges relied on evidence of the *noninteractive* services' ability to steer, and their credible threats to do so, as ameliorating the anticompetitive effect of the Majors' complementary oligopoly.

More particularly, SoundExchange asserts that Spotify developed a substantial ability to influence listening on its platform subsequent to the execution of its 2013 Agreements with the Majors. *See, e.g.*, Orszag WDT ¶¶ 138-151; 9/2/20 Tr. 5414 (Fowler); 9/2/20 Tr. 5197-98 (Piibe). Spotify's purported power to influence market share, according to SoundExchange, flowed mainly from its alleged ability to influence market share through economically strategic placement of sound recordings within Spotify-controlled playlists. Orszag WDT ¶¶ 141-146.³² By way of background, in July 2015, Spotify launched playlists personalized for its subscribers, including Discovery Weekly, to assist subscribers in identifying new music tailored to their listening preferences. Orszag WDT ¶ 62. Contemporaneously, Spotify began to prioritize those playlists and additional Spotify-curated playlists, for various genres, by giving them

³² SoundExchange further notes that [REDACTED] has [REDACTED]. SX PFFCL ¶¶ 370-71 (and record citations therein); Orszag WDT ¶ 148. Less significantly, SoundExchange avers that Spotify can also leverage its [REDACTED]. Orszag WDT ¶ 147.

prominent and superior locations in its search and display features. Trial Ex. 5619 ¶¶ 15, 17 (CWDt of Jennifer Fowler). *See also* SX PFFCL ¶¶ 359-360 (and record citations therein). From 2015 to 2017, these Spotify-curated playlists increased as a share of listening on Spotify from less than 20% to approximately 31% of Spotify platform listening. Orszag WDT ¶ 142.

According to SoundExchange, the economic value of these Spotify-curated playlists extends beyond a subscriber's initial accessing of songs on the playlist. Listeners also can add songs from those playlists onto their own playlists and into their own music collections, and, having positively experienced music curated by Spotify, they are more likely to search for music from the same artists, and thus from the same record company. SX PFFCL ¶¶ 363-364, 366 (and record citations therein).

Consequently, SoundExchange avers that record companies consider playlists to be [REDACTED], and thus they devote considerable effort and resources to the development and implementation of playlist strategies. SX PFFCL ¶¶ 365, 367 (and record citations therein). Further, the [REDACTED]. *See* Trial Exs. 5070-5072; Harrison WDT ¶¶ 49, 52. SoundExchange further relies on the testimony of Michael Sherwood, a Warner Senior Vice President responsible for overseeing its Spotify and other streaming service accounts, Trial Ex. 5620 ¶¶ 1-2 (WDT of Mike Sherwood), who testifies that [REDACTED]. 9/9/20 Tr. 5921-22 (Sherwood).

Moreover, SoundExchange emphasizes that Pandora's own economic expert witness, Professor Shapiro, acknowledges that, by the time Spotify and the Majors were negotiating their 2017 Agreements, Spotify already possessed the ability to influence listening and record company market share through its selection and placement of songs on Spotify-curated playlists. 8/19/20 Tr. 2868 (Shapiro) ("Spotify has some ability to influence listening through a service-generated playlist. [Mr. Orszag] emphasizes that. I agree that they definitely have that ability.").

SoundExchange relies yet again on Professor Shapiro's testimony to argue that, when a streaming service such as Spotify has the technical ability to steer, its credible threat to steer against a Major during contract negotiations can constitute sufficient leverage by which Spotify can negotiate better terms for itself. *See* 8/20/20 Tr. 3067-68 (Shapiro). SoundExchange's expert is in full agreement, testifying that in negotiations related to steering, as in negotiations generally, "it is often the threat that can influence outcomes ... *as long as the threat is credible.*" 8/11/20 Tr. 1255 (Orszag) (emphasis added); *see also id.* at 1211-13, 1347-48.

Continuing its attempt to build its steering argument on the back of Professor Shapiro's own testimony, SoundExchange points out that he admitted that a steering threat could be implicit as well as explicit. 8/20/20 Tr. 3066-67 (Shapiro). Moreover, the evidence of [REDACTED], might be seen, Professor Shapiro recognizes, [REDACTED]. 8/20/20 Tr. 3052 (Shapiro). For these reasons, SoundExchange emphasizes, in *Web IV* Professor Shapiro testified that "if the services have substantial ability to steer" then the market can be "workably competitive" notwithstanding that each Major remains a Must Have. *See* 8/20/20 Tr. 3036 (Shapiro).

SoundExchange does recognize that, for Spotify to be able to transform its *technological* ability to engage in editorial steering into [REDACTED], its threats must be *credible* to a Major, so that actual steering is neither needed nor implemented. SX PFFCL ¶ 354 (citing Orszag WDT ¶149). On this score, Professor Shapiro likewise is in full agreement. He testifies that steering threats are "depend[ent] on the *credibility* of these threats" as well as the "fallback" positions of the parties in the event the threat of steering leads to a failure of the parties to enter into a licensing agreement. 8/20/20 Tr. 3053 (emphasis added).

The Services strongly disagree with SoundExchange's steering argument. First, they minimize the economic importance of playlist listening – where steering might take

place – notwithstanding its recent growth. In particular, they criticize Mr. Orszag for trumpeting that 31% of all Spotify listening is to Spotify-curated playlists, when this figure obviously means that approximately 69% of all listening remains on-demand in nature and thus *outside of Spotify’s curatorial gatekeeping capacity*. Thus, the Services argue, the defining feature of Spotify (and other interactive services) remains the offering to a subscriber of access to a virtually complete repertoire of songs for on-demand listening. Services RPFCL ¶ 358 (and record citations therein). Google’s economic expert, Dr. Leonard, takes note of a behavioral study of Spotify users [REDACTED] See Trial Ex. 2122 at 8. Dr. Leonard takes from the 69%:31% split referenced above and the [REDACTED] that “[a] user’s ability to play any song on demand remains a defining characteristic of interactive services and a driver of user demand for these services.” Trial Ex. 2160 ¶ 73 (CWRT of Gregory Leonard) (Leonard WRT).

Further, on a fundamental level, the Services assert that SoundExchange misapprehends the concept of steering, untethering the concept from its economic significance. The relevant form of “steering” for purposes of this proceeding, the Services maintain, is one that generates price competition among the Majors. Services PFFCL ¶ 64 (citing *Web IV*, 81 FR at 26343 (“[s]teering is synonymous with price competition in this market”) and *SoundExchange*, 904 F.3d at 52 (affirming the Judges’ decision that “the likely effect of steering in the music industry would be to promote price competition”))).

The Services distinguish *Web IV* in this regard by emphasizing that the Judges in that case had relied on two agreements that contained *explicit* steering provisions designed to generate lower royalty rates in exchange for additional plays – what the Services characterize as the essence of steering. First, the Services point to the agreement between Pandora and Merlin for Pandora’s noninteractive service, which provided that “the [REDACTED]” as set out in the agreement. *Web IV*, 81 FR at 26356. Second, the

Services refer to the *Web IV* Judges' description in that determination of an "iHeart/Warner Agreement [that] incorporates the same economic steering logic as the Pandora/Merlin Agreement." *Id.* at 26375.

But, in the present case, the Services aver that the Majors had [REDACTED]. In fact, the Services maintain, Mr. Orszag concedes this point, testifying in response to a question from the Judges that [REDACTED]." 8/12/20 Tr. 1536 (Orszag); *see also id.* at 1711 (Orszag) ("[REDACTED]."); Shapiro WRT at 16 (summarizing lack of evidence in Orszag WDT and noting "when Mr. Orszag discusses how the major record companies have responded to the growing role of service-generated playlists, he does *not* claim they have reduced their royalty rates to encourage increased plays of their material"). In this regard, Google's economic expert witness, Dr. Peterson, noted that [REDACTED]. Peterson WRT ¶ 74.

The Services also point to the hearing testimony of [REDACTED], who acknowledged that [REDACTED]. Specifically, they note that: (1) [REDACTED] 9/2/20 Tr. 5371-72 ([REDACTED]) (emphasis added); (2) [REDACTED]." 9/3/20 Tr. 5698 ([REDACTED]) (emphasis added); and (3) [REDACTED] 9/3/20 Tr. 5531-32, 5480-81 ([REDACTED]) (emphasis added); *see also* Trial Ex. 4014 at 3 ("[REDACTED].").

Accordingly, the Services maintain that [REDACTED] present no evidence or testimony that [REDACTED]. *See* 9/02/20 Tr. 5435 (Fowler); 9/09/20 Tr. 5949-50 (Sherwood). Accordingly, the Services note that, [REDACTED], Mr. Orszag was compelled to concede that competition for playlist slotting is not based on royalty rate discounts (or side payments). 8/11/20 Tr. 1313 (Orszag). The Services maintain that this testimony is powerful evidence "undermining [the] theory that playlist competition is an outgrowth of steering-based price competition." Services RPFFCL ¶ 359. In fact, the

Services note, [REDACTED]. *See* Services PFFCL ¶ 66 ([REDACTED]) (and record citations therein).

The Services also take issue with Spotify's claim that the 31% of listening that occurs on Spotify-curated playlists is entirely subject to Spotify's steering capabilities. Specifically, the Services note that 17 percentage points of that listening (more than half of the 31%) occurs on algorithmically-curated playlists that are personalized for each user based on his or her listening behavior and thus outside Spotify's control." *See* Orszag WDT ¶ 61. Moreover, no SoundExchange witness provided any evidence that Spotify exerts any price-based influence over this algorithm (or over the autoplay algorithm), such as in the Pandora/Merlin agreement relied upon by the Judges in *Web IV*. *See* 9/2/20 Tr. 5406 (J. Fowler); 8/11/20 Tr. 1316 (Orszag).

The Services also assert that SoundExchange is exaggerating the importance of playlists within Spotify's entire streaming platform. It notes [REDACTED] indicating that "[REDACTED]" Trial Ex. 2074. In the same vein, the Services take note of the testimony of a [REDACTED], who acknowledged that, for [REDACTED] 9/2/20 Tr. 5432-33, 5443 ([REDACTED]). Furthermore, the Services emphasize that SoundExchange relies essentially on supposition that playlist listening drives listeners' subsequent on-demand streaming decisions, noting the absence of any detailed studies that would confirm this hypothesis. Services RPFCL ¶¶ 365-366 (and record citations therein).

The Services further note that, in the [REDACTED]. 9/2/20 5370-71 (Piibe); 9/3/20 Tr. 5537-39 (Adadevoh).

According to the Services, [REDACTED]. Essentially, according to the Services, [REDACTED]t. *See* Services PFFCL ¶¶ 151-156 (and record citations therein).

To make clear the scope of the relevant [REDACTED], the Services rely on the exact language of the 2017 agreements between the Majors and Spotify. The Services

assert that this contract language, set forth below, [REDACTED], thus disposing of the very notion that [REDACTED]:

The Sony-Spotify Agreement:

[REDACTED]

Trial Ex. 5011 at 36 (Sony-Spotify 2017 Agreement); *see also* Trial Ex. 5074 at 22 ([REDACTED] in Sony-Spotify immediately prior 2013 Agreement) (emphasis added).

The Universal-Spotify Agreement:

[REDACTED]

Trial Ex. 5037 at 45, 96 (Universal-Spotify 2017 Agreement); *see also* Trial Ex. 2062 at 38 ([REDACTED] in Universal-Spotify 2013 Agreement).

The Warner-Spotify Agreement:

[REDACTED]

Trial Ex. 5020 at 20, 36 (Warner-Spotify 2013 Agreement).³³

The Services note a consensus between SoundExchange and Services' expert witnesses that [REDACTED]. *See, e.g.*, 8/12/20 Tr. 1709 (Orszag); Leonard WRT ¶ 66. More particularly, they point to Dr. Leonard's testimony that [REDACTED]. Leonard WRT ¶¶ 60-63 (reviewing [REDACTED] provisions in the Spotify agreements); *see also* 8/25/20 Tr. 3716-17 (Peterson); *see also* Peterson WRT ¶¶ 69-70 (noting the [REDACTED]); 8/12/20 Tr. 1699-1701, 1704 (Orszag) (acknowledging that [REDACTED]).

SoundExchange maintains, though, that these [REDACTED] have not been sufficient to [REDACTED], as discussed *supra*). Specifically, SoundExchange argues:

³³ [REDACTED]. *See* Trial Ex. 5038 at 24 ("[REDACTED]"). *See also* 9/3/20 Tr. 5549-51, 5557-61 (Adadevoh) (acknowledging these provisions were intended to [REDACTED]).

1. [REDACTED]. *See, e.g.*, 9/3/20 Tr. 5702 (Harrison). SoundExchange notes that [REDACTED] construed the [REDACTED]. *See* Trial Exs. 4031 at 37 ([REDACTED]) & 5020 at 20 ([REDACTED]).
2. A service that curates its own playlist, such as Spotify, could [REDACTED]. *See* 9/3/2020 Tr. 5700-01 (Harrison) (discussing the Spotify-Universal agreement).
3. There are significant [REDACTED], including the Majors' [REDACTED]. Orszag WDT ¶ 150 ("[REDACTED]."). And, even if a record company [REDACTED]. *See id.* [REDACTED]). Moreover, the [REDACTED]. *See* 9/2/20 Tr. 5404-06, 5446-47 (J. Fowler).
4. Even [REDACTED]. 8/11/20 Tr. 1317-18 (Orszag); *accord* Trial Ex. 4017 at 4 (noting that [REDACTED]); Trial Ex. 2124 at 1 ("[REDACTED]); 9/2/2020 Tr. 5204 (Piibe) ("[REDACTED]).
5. Even if the [REDACTED], SoundExchange claims they would nonetheless be left with [REDACTED]. It asserts that [REDACTED] — but that would [REDACTED]. *See, e.g.*, Harrison WDT ¶ 56; Adadevoh WDT ¶ 34, 38 & n.27; Piibe WDT ¶¶ 29-30; 9/3/20 Tr. 5482 (Adadevoh).

Consequently, SoundExchange maintains, it is unsurprising that the record contains no evidence that [REDACTED]. *See, e.g.*, 9/3/20 Tr. 5481 (Adadevoh); *accord id.* at 5565 (Adadevoh) (noting that [REDACTED]). And, when Universal asserted to Spotify that the latter was [REDACTED]. 9/3/20 Tr. 5702 (Harrison).

Additionally, SoundExchange avers that, even assuming *arguendo* the [REDACTED] and effectively competitive. Specifically, SoundExchange explains that [REDACTED]. Accordingly, although Majors may want or need to [REDACTED] such as those quoted above, [REDACTED]. Rather, according to SoundExchange, Spotify is [REDACTED] or, importantly here, *to* [REDACTED]. *See* 8/11/20 Tr. 1254 (Orszag).

That is, as Mr. Orszag explains, once a streaming service has successfully used a [REDACTED], the Major may in turn seek [REDACTED]. *See* 8/11/20 Tr. 1331-32 (Orszag). By similar economic logic, a Major that had entered a negotiation [REDACTED] may decide [REDACTED]. *See* 9/2/20 Tr. 5203-05 (Piibe).

Thus, SoundExchange maintains, *the mere presence* of [REDACTED], on which the Services rely, is hardly conclusive evidence that the market lacks effective competition. Rather, as Professor Shapiro himself acknowledges, in an effectively competitive market, a service might agree to accept an [REDACTED]. 8/19/20 Tr. 3089-92 (Shapiro).

The Services respond, though, that the notion that the [REDACTED] was contradicted by SoundExchange's own witnesses. Specifically, as the Majors and Spotify negotiated over terms in 2016 and 2017, they [REDACTED]. *See, e.g.* 9/3/20 Tr. 5551 (Adadevoh) (agreeing that [REDACTED]"); *see also* 9/3/20 Tr. 5704-05 (Harrison).

Moreover, the Services aver, the terms of [REDACTED] with the [REDACTED]. *See, e.g.,* Peterson WRT ¶ 69. That is, while Spotify negotiated [REDACTED], Spotify remained [REDACTED]. Trial Ex. 5074 at 22; Trial Ex. 5020 at 20, 36. *Indeed, SoundExchange's own witness, Mr. Orszag, concedes that throughout Spotify's presence in the United States streaming market, [REDACTED]* 8/12/20 Tr. 1703-04 (Orszag); *see also* Services PFFCL ¶ 100 (summarizing additional evidence).

The Services also assert that there is no evidence that, as SoundExchange maintains, the Majors negotiated for [REDACTED]. Instead, the Services point to the Majors' imposition of [REDACTED]. *See* Shapiro WRT at 22 (noting the Majors' recognition that [REDACTED]).

More particularly, the Services explain that the Majors' [REDACTED] ensured that a [REDACTED]. That is, unless other labels [REDACTED]. 8/20/20 Tr. 3058

(Shapiro); *see also* 8/13/20 Tr. 1905-06 (Orszag) ([REDACTED]). The Services also rely on the testimony by Mr. Harrison, the Universal executive appearing at trial, who agreed that [REDACTED],” and that “[REDACTED]” 9/3/20 Tr. 5705-06 (Harrison).³⁴

Importantly, SoundExchange’s position – that the [REDACTED] in the 2017 agreements reflect a [REDACTED] – is inconsistent with SoundExchange’s argument, itemized *supra*, that, for “[REDACTED]” SX PFFCL ¶ 388.

In addition to their rejoinders to SoundExchange’s [REDACTED] assertions, set forth *supra*, the Services take issue with each of SoundExchange’s additional arguments regarding the [REDACTED]. First, they note that the only example SoundExchange could muster regarding potentially [REDACTED] was related to [REDACTED] entered into between [REDACTED]. However, there is no evidence in the record regarding how [REDACTED] interpreted the [REDACTED] and, further, that the context for any possible disagreement [REDACTED]. Further, there is no record evidence indicating that Pandora had the intent to influence, or did influence, [REDACTED]’s streams. Moreover, the Services note that there is no sufficient proof that the [REDACTED] in the [REDACTED] agreement are the same in all respects as those in the [REDACTED] agreement. Services RPPFCL ¶¶ 389-390.

The Judges find that SoundExchange’s reliance on [REDACTED] is unavailing because [REDACTED]. Moreover, although [REDACTED] is a participant in these proceedings (represented by SoundExchange and its counsel), no [REDACTED] witness testified that [REDACTED] sound recordings was – to its understanding – a [REDACTED]. More broadly, the Judges find wholly undeveloped SoundExchange’s speculative assertion that a service and a label may have [REDACTED]. Of course, they

³⁴ Because Mr. Harrison testified, without dispute, that Universal ([REDACTED]) could only use the [REDACTED], Universal apparently could not, for example, [REDACTED]

might have (or claim to have) [REDACTED], but that possibility hardly indicates that [REDACTED]. Moreover, the parties (services and labels) spend substantial sums on attorneys to draft contract language [REDACTED], the Judge are unwilling to find that industrywide [REDACTED], as a class, are [REDACTED].

Second, the Services' assert as meritless SoundExchange's argument that, even under [REDACTED], Spotify could [REDACTED]. The Services point out that [REDACTED] – the only label SoundExchange cites for this argument – prohibits “any form of preferential or otherwise enhanced *positioning, placement or status*” and provides that [REDACTED] Trial Ex. 5037 at 45, 96.

Moreover, the Services aver that the Majors do not [REDACTED]. In fact, the Services note, in 2017, [REDACTED]. See Trial Ex. 4014; 9/3/20 Tr. 5537-39 (Adadevoh) (reviewing Trial Ex. 4014, an internal Warner analysis of [REDACTED] and agreeing that Warner had found [REDACTED]”).³⁵

The Judges find that there is insufficient evidence to support SoundExchange's claim that it is hamstrung in attempting to [REDACTED]. Given the ostensible greater importance the Majors place in this proceeding on [REDACTED] – see Trial Ex. 2124 at 1 (“[REDACTED] – the Judges find that a Major would [REDACTED]. Moreover, [REDACTED].

Further in this regard, the Services disagree with SoundExchange's claim that record companies would have “[REDACTED].” Rather, the Services point to, *inter alia*, Trial Ex. 2108, in which [REDACTED]. Trial Ex. 2108 at 2-3. The Services assert that this [REDACTED] shows the Majors have an available [REDACTED]. Further, the Services maintain that the mere fact that [REDACTED] is consistent with [REDACTED]

³⁵ The Services also note that SoundExchange separately claims that the Majors [REDACTED]. This claim [REDACTED], belies SoundExchange's claim that it [REDACTED] The Judges agree with the Services.

rather than with speculation that [REDACTED]. *See* Services RPPFCL ¶ 395 (and record citations therein).

The Judges find there is inadequate evidence to demonstrate that the Majors [REDACTED], for the reasons given by the Services. Further, consistent with the Judges comment regarding legal representation *supra*, the Majors have at their disposal highly talented commercial, corporate and litigation attorneys, who receive handsome fees for [REDACTED]. Although [REDACTED], a sufficient record of [REDACTED] must be demonstrated by a more persuasive record than exists in this proceeding. Finally, in this regard, if the Majors [REDACTED], why does SoundExchange argue that the [REDACTED]? *If [REDACTED]*? Indeed, the fact that there is [REDACTED] in the record, as discussed *supra*, does not mean that [REDACTED]; it points to the value of such [REDACTED]. The Majors' claims 1) that [REDACTED] and 2) that [REDACTED], are blatantly inconsistent.

Accordingly, on balance the Judges find that there is insufficient evidence to demonstrate that [REDACTED] in their stated intent. The Judges take particular note of SoundExchange's acknowledgement, discussed *supra*, that the Majors (1) had [REDACTED], (2) did not [REDACTED], (3) found it difficult to [REDACTED], (4) asserted [REDACTED], (5) failed to [REDACTED], and (6) agreed to [REDACTED]

Shifting from the issue of [REDACTED], the Services disagree with SoundExchange regarding the economic importance of this issue. They note that, pursuant to an internal Sony document, [REDACTED] comprise [REDACTED] and that, [REDACTED], replacing those [REDACTED] with [REDACTED] would only [REDACTED]. Trial Ex. 4017 at 4. *See also* 9/03/20 Tr. 5544-45 (Adadevoh) ([REDACTED]); Trial Ex. 4014 at 3.

The Judges agree with the Services that Spotify's [REDACTED] to suggest a sea change in Spotify's pricing power. And, there is no evidence that Spotify could alter its

business model by engaging in a wholesale [REDACTED] with subscribers remaining indifferent to such a fundamental change in the service. This is critical because the Judges do not lose sight of the purpose of this particularized analysis of the benchmark interactive service, which is to determine if Spotify has changed in a manner that lessens or eliminates the complementary oligopoly power of the Majors, such that an effective competition adjustment in the target noninteractive statutory market is either unnecessary or should be reduced. A [REDACTED] (themselves generating but a minority of Spotify's listening) is wholly uninformative as to this issue.³⁶

**d. The (Partial) Evidence and Testimony regarding the Majors'
Negotiations with Spotify Leading to their 2017 Agreements**

In addition to its foregoing arguments, SoundExchange relies on evidence and testimony regarding the negotiations between Spotify and the three Majors. Sound

³⁶ The Judges discuss the negotiation of "[REDACTED]" with Spotify later in this Determination. But, the Judges note here that they find unavailing Mr. Orszag's attempt to de-contextualize the impact of [REDACTED] by his noting that a [REDACTED]% loss in Sony's market share would equate to a \$[REDACTED] annual revenue loss. Mr. Orszag reports that in 2018 Sony's digital music U.S. revenue totaled \$[REDACTED]. Orszag WDT tbl.13. Thus, the \$[REDACTED] short-term revenue loss posited by Mr. Orszag equals [REDACTED] about [REDACTED] one percent of Sony's total annual U.S. digital music revenue. Although \$[REDACTED] is a large sum in many contexts, it is small in the present context, especially because the purpose of the exercise is to determine Spotify's pricing power relative to the complementary oligopoly market power of the Majors. Clearly the \$[REDACTED] figure fails to reflect the appropriate magnitude of the impact of Spotify's [REDACTED]. Such distorted use of monetary sums is inappropriate. Cf. Pablo J. Barrio *et al.*, *Improving the Comprehension of Numbers in the News*, PROC. 2016 CONF. HUM. FACTORS COMPUTING 1 (Ass'n for Computing Mach. 2016) ("Unfamiliar measurements make up much of what we read, but unfortunately carry little or no meaning ... as they can be difficult to interpret without the appropriate context.") (available on *Google Scholar* at www.cs.columbia.edu (accessed June 9, 2021)).

Exchange avers that this evidence and testimony show that in the run-up to the execution of the 2017 Agreements [REDACTED]. Accordingly, the Judges next consider that evidence and testimony.

Before they weigh the record in that regard, the Judges take note of the nature and sequencing of that evidence and testimony. *First*, SoundExchange proffered this information in a disjointed manner. Multiple documents from the archives of the three Majors were introduced — primarily email correspondence between and among various executives within each Major — discussing the Spotify negotiations. However, none of the individuals who actually negotiated with Spotify – and virtually none of the authors or recipients of these internal emails – provided oral or written testimony at the hearing. Rather, SoundExchange proffered witnesses from the Majors who had some knowledge of these documents and second-hand knowledge of the oral negotiations between their employers and Spotify.³⁷ The Judges would have much preferred to hear from first-hand witnesses from the Majors’ negotiating teams, who actually bargained with Spotify, in order to appreciate how the usual bargaining dominance of the Majors might (or might not) have been usurped by Spotify. Further, the documents to which the Majors’ second-hand witnesses testified are not always models of clarity, and these second-hand

³⁷ The Judges admitted these documents into the record, finding them sufficiently authenticated, and, exercising their discretion to admit hearsay evidence, the Judges did not exclude these documents on that basis. But the issue of *admissibility* does not raise the same concerns regarding the *weight* to be given to documents written or received by relevant actors who were not called to testify to explain the context, completeness and ambiguities, if any, relating to those documents. Further, the actual negotiators could have been called to testify regarding oral negotiations (the Majors are all parties in this proceeding) and to explain and contextualize statements contained in internal emails. Thus, to the extent the record evidence of the Spotify-Majors negotiations is incomplete or uncertain, the Judges find that SoundExchange must bear the consequences of such deficiencies.

witnesses could not go beyond the four corners of the documents to explain, identify or provide a sufficient economic context for these documents. *See* MANNE & WILLIAMSON, *supra* at 645; *see also* *Web IV*, 81 FR at 26352 (When “the Judges’ task is to determine ... *economic significance* ... the contracts are but one ... piece of evidence ... [and] [w]here ... a transaction is part of a complex ... business relationship it is appropriate – *even necessary* – for the Judges to consider other evidence and analysis to determine the true economic value of the transaction.”) (emphasis added). And, to the extent oral negotiations between Spotify and the Majors, or between the Majors’ negotiating teams and their superiors, were never summarized or were summarized in writings not in evidence, the record is incomplete in the absence of testimony from the Majors’ negotiators and other direct decision-makers.

Second, SoundExchange proffered only correspondence from the licensor side, that is, from the Majors. The record does not contain any documentary evidence (or testimony, for that matter) *from Spotify* regarding its negotiations with the Majors. Accordingly, there is an incomplete and one-sided record of the negotiations upon which SoundExchange relies.³⁸ SoundExchange asserts that this incompleteness is inconsequential because what is relevant are the Majors’ understandings and perceptions of [REDACTED].

The Judges agree that the Majors’ understanding of Spotify’s position [REDACTED] is the *ultimate* relevant factor in explaining how and why the Majors responded as they did in negotiations. However, to determine whether the Majors’ claimed understanding is *credible*, and to weigh the value of each factor, the Judges would need to know much more about how Spotify bargained and the representations it

³⁸ In previous proceedings, the Judges have considered negotiation documents when the record contained such material from *both* counterparties. That is not the case with the record here.

made. The actual negotiators would have been the best witnesses to provide that level of detail to assist the Judges in determining whether the Majors' [REDACTED] is factually persuasive.

This is crucial for two reasons. First, the Services offer up a quite different explanation. They argue that the Majors were simply utilizing their complementary oligopoly power to [REDACTED]. *See* Services PFFCL ¶¶ 138-150 (and record citations therein). SoundExchange is making an argument that relies on facts that, if relied upon by the Judges, would lead to a radical departure from the bargaining analysis they identified and adopted in *Web IV* – one which is consistent with the economic framework of complementary oligopoly that has an unchallenged lineage dating back to the 19th century work of the economist A.A. Cournot. *See Web IV*, 81 FR at 26342. Such a departure from the prior bargaining framework is certainly conceivable, but the hearing record necessary to support the task should be substantial; instead, SoundExchange's presentation appears to the Judges to have been stitched together and, for the reasons discussed *supra*, lacking a sound basis in economics, as well as in the very principles and dynamics of bargaining that it applies to the hypothetical noninteractive market.³⁹

The Judges keep these considerations in mind as they analyze below the parties' arguments regarding the import of the relevant strands of evidence and testimony regarding Spotify's negotiations with the Majors.

i. The Universal-Spotify Negotiations

Universal and Spotify began their negotiations to replace their 2013 agreement in [REDACTED], *see* Trial Ex. 4027 at 1, and completed the negotiations at [REDACTED].

³⁹ By contrast with the problematic record relating to the effects of Spotify's supposed new-found pricing power, and as discussed in detail *infra*, the Majors' internal documents and hearing testimony reveal [REDACTED]. As also discussed *infra*, the Majors' [REDACTED]

See Trial Ex. 5037 at 1. Early in the negotiations, according to an internal company document, Universal identified [REDACTED] as an issue to be addressed. Trial Ex. 5410 at 1. SoundExchange notes that Universal's subsequent internal communications reflect its [REDACTED]. Trial Ex. 4016 at 1 ("[REDACTED]"); *see also* Trial Exs. 4019, 5429 at 1. Further, some Universal negotiators – again, *who did not testify* – expressed in internal documents their belief that [REDACTED], Trial Ex. 5422 at 1, with the author of an internal Universal email, adding [REDACTED]. Trial Ex. 5221 at 5.⁴⁰

When apprised of [REDACTED], according to an internal Universal email, Spotify acknowledged to Universal that it [REDACTED]. Trial Ex. 5413 at 1. Consistent with [REDACTED], Universal's testifying witness, Aaron Harrison, acknowledged that [REDACTED]. 9/3/20 Tr. 5701 (Harrison).

In an attempt to [REDACTED], Universal ultimately proposed that [REDACTED]. Trial Ex. 5410 at 1. However, Universal's internal emails indicated that Spotify had [REDACTED] Trial Ex. 5421 at 1. Rather, Spotify took the position that it would be "[REDACTED]." Trial Ex. 5414 at 1. Ultimately, the final 2017 Agreement included [REDACTED]. *See generally* Trial Ex. 5037. (However, as noted above, the 2017 Agreement included [REDACTED])

In response, the Services point out, as an initial matter, that the statements in Trial Ex. 5414 constitute double hearsay, in that they repeat [REDACTED] (the first hearsay) to a [REDACTED], which were then repeated in the exhibit (the second hearsay). The Services also argue that the Judges should give no weight to Trial Ex. 5521, which also contains double hearsay, *viz.*, [REDACTED] [REDACTED] (the first hearsay), repeated

⁴⁰ Because the author of the email did not testify, the unusual placement and styling of this alleged quote (itself hearsay) was not the subject of examination at the hearing.

in an internal e-mail (the second hearsay). In any event, the Services maintain, no part of the [REDACTED] that would generate price competition.

Moreover, the Services aver that these statements are flatly inconsistent with the acknowledgement by Universal's testifying witness, Mr. Harrison, that Universal [REDACTED], but rather Universal sought to [REDACTED] Trial Ex. 4016 at 1. Thus, Universal's negotiating stance, according to the Services, was to [REDACTED]. To that extent, the Services do acknowledge that Universal [REDACTED] — *see* Harrison WDT ¶ 56; 9/3/2020 Tr. 5743-5744 (Harrison) — but Universal was [REDACTED]. *Id.* at 5744 (Harrison). Accordingly, Universal had to rely on the [REDACTED]. Harrison WDT ¶ 56. Additionally, the Services note that the 2017 Agreement [REDACTED].

The Services also contest SoundExchange's characterization of [REDACTED]. Specifically, the Services point to the [REDACTED], which requires that Spotify [REDACTED] and that Spotify would "[REDACTED]" Trial Ex. 2062 at 53-54 (2013 Spotify-Universal Agreement).

In fact, Trial Ex. 5429 (a 2016 negotiation email cited by SoundExchange) acknowledged that the [REDACTED] Trial Ex. 5429 at 4. Moreover, according to the Services, Spotify's [REDACTED] rendered dubious, unsubstantiated, and unwarranted Universal's [REDACTED].

Further, as an economic matter, the Services assert that Universal's [REDACTED] gives away the game — Universal was seeking to [REDACTED] that the Services characterize as a "perverse conception of 'price competition' to say the least." Services RPFCL ¶¶ 419-421 (and record citations therein). Moreover, the Services aver, in any event, the presence of [REDACTED] Spotify's agreements with the [REDACTED]. *See* Services RPFCL ¶ 425

The Judges find that the evidence and testimony relating to these negotiations, relied upon by SoundExchange, are insufficient to demonstrate that Spotify had acquired

any greater pricing power in connection with the negotiation of the 2017 Agreement. The [REDACTED] in the 2013 Agreement [REDACTED] in the 2017 Agreement, as confirmed in Universal's own internal e-mail. Further, as the Services point out, Universal's testifying witness, Mr. Harrison, contradicted the key point that SoundExchange is attempting to make with regard to these negotiations: [REDACTED] 9/3/20 Tr. 5701 (Harrison). *This broad statement clearly undermines SoundExchange's assertion that [REDACTED].*⁴¹ Further, because Universal's agreement to [REDACTED], the Judges agree with the Services that Universal's pointed attempt to have Spotify agree to [REDACTED] demonstrates that *Universal was [REDACTED]*.

On a more general basis, the Judges find SoundExchange's portrayal of Universal as essentially a "pitiful helpless giant" in negotiations to be at odds with the reality of its status as a complementary oligopolist wielding a Must Have repertoire. It did not have to [REDACTED], but rather, *ceteris paribus*, could have [REDACTED].

Additionally, SoundExchange's assertion that Universal [REDACTED] in the 2017 Agreement is problematic for two reasons. First, Universal claimed to be

⁴¹ The Judges find startling, though, the Services' dismissal – as a "perverse conception of 'price competition'" – of SoundExchange's more nuanced claim that [REDACTED]. This is precisely the phenomenon that Professor Shapiro enthusiastically endorsed in *Web IV* and which the Judges adopted. *Web IV*, 81 FR at 26366 (Professor Shapiro testifying that it was "absolutely" correct that "the threat of steering ... pushes [the record companies] ... towards their original [market share] percentages to avoid being that odd man out who was the holdout for the higher price ..."). In any event, Mr. Harrison's testimony that [REDACTED] renders moot the Services' jarring attempt to repudiate the notion of a Major agreeing to lower rates in exchange for protection from steering. Moreover, if, hypothetically, the facts had demonstrated [REDACTED], then [REDACTED] might have made sense as a way for a Major to avoid the situation where it [REDACTED]. However, under SoundExchange's *own* theory of the case, as discussed elsewhere in this Determination, the idea that the Majors thought [REDACTED], would be a chimera, given that the Majors aver that [REDACTED].

[REDACTED], so why did Universal [REDACTED]? Again, SoundExchange’s characterization of this largest Must Have Major as some sort of pitiful helpless giant (like Gulliver restrained by the Lilliputians) is simply not credible, because, as discussed elsewhere in this Determination, Spotify would be out of business [REDACTED] without a Major’s repertoire, whereas Universal and the other Majors would continue in business, as Spotify’s listeners would migrate to a substitute streaming service. And, if the [REDACTED] as SoundExchange claimed (because, as discussed *supra*, a Major could not [REDACTED] then why was Universal (or any Major) [REDACTED] – especially given that SoundExchange proffered evidence that the Majors claimed [REDACTED].

Moreover, in *Web IV*, SoundExchange provided substantial detail regarding how the Majors would respond to thwart an attempt by a service to engage in steering as a means of price competition. A Major would threaten to black out its repertoire on that service or actually do so (a threat that remains viable, as discussed in this Determination). Second, a Major could demand that all royalties be paid up front on a non-refundable basis, according to historic market shares, making subsequent market share deviations costly (*i.e.*, the marginal cost of deviating toward a Major beyond its historic share would be a positive royalty, compared to the zero marginal cost of playing a marginal sound recording as part of a Major’s historic share, because the royalties based on historic market share had been prepaid). Finally, in *Web IV*, SoundExchange noted that each Major could insist on an MFN or similar anti-steering/anti-discrimination clause, making deviations from historic share play a breach of contract. *Web IV*, 81 FR at 26364-65.⁴²

⁴² The very concept of licensors requiring historic shares to be maintained appears inconsistent with effective competition. In *Web IV*, the Judges noted that “demands by the Majors to prevent steering by insisting that a noninteractive service not deviate from an historical (“natural”) division of market shares would be a classic example of anticompetitive conduct.” *Web IV*, 81 FR at 26373 (citing *Blue Cross & Blue Shield United of Wisconsin v. Marshfield Clinic*, 65 F.3d 1406, 1415 (7th Cir. 1995) (Posner, J.).

In *Web IV*, the Judges acknowledged the capacity of the Majors to engage in such conduct, and the Judges characterized such conduct as simply alternate expressions of their complementary oligopoly power that, under the statute, the Judges were intending to mitigate, in order to identify rates that would be set in an effectively competitive market. *Web IV*, 81 FR at 26373-74. In the present proceeding, SoundExchange has not provided a sufficient evidentiary basis to show that Spotify would be immune from such tactics. Moreover, it would be in each Major's long-run interest, acting alone, *yet consciously aware of the parallel incentives of the other Majors*, to threaten and, if necessary, follow through on such actions, because of each Major's individual Must Have status (and each Major's knowledge of the other Majors' Must Have status).⁴³ Simply put, the Majors' power provides them with multiple tactics, which, if triggered, would confront Spotify with certain and prompt economic ruin, as its subscribers expeditiously defected to Apple, Amazon, Google, or one of Spotify's smaller competitors.

⁴³ Indeed, an important point made by Professor Willig, SoundExchange's Shapley Value and bargaining expert, regarding the noninteractive market is fully applicable here. Each Major, as a Must Have, would recognize its power to withhold (or threaten to withhold) a license in order to maximize the benefit of the bargain. *See also* Richard A. Posner, *Oligopoly and the Antitrust Law: A Suggested Approach*, 21 STAN. L. REV. 1067, 1081a n.39 (1969) (A "meeting of the minds" among oligopolists is "illuminated by game theorists [who note that] mutual dependence ... demands ... collaboration [that is]... tacit if not explicit"). There is no reason to believe that this phenomenon does not exist in the unregulated interactive music licensing market. Kristelia A. Garcia, *Facilitating Competition by Remedial Regulation*, 31 BERKELEY TECH. L.J. 183, 188 (2016) ("In an industry like music licensing ... parallel pricing and tacit collusion can ... remov[e] the threat of meaningful competition from the marketplace.").

Accordingly, the Judges reject the argument that Spotify's economic position generated a change in bargaining and market power [REDACTED]. Rather, it is apparent to the Judges that Universal must have had [REDACTED].⁴⁴

ii. The Warner-Spotify Negotiations

At the outset of negotiations regarding the 2017 Agreement, Spotify represented to Warner that it had [REDACTED]. 9/3/20 Tr. 5479; 5526-27 (Adadevoh).

In response to a Spotify proposal for [REDACTED], Warner explored with Spotify a [REDACTED]. *See* Trial Exs. 5264 at 4; 5265 at 2; 9/3/2020 Tr. 5495-96 (Adadevoh). According to Warner's testifying witness, Ms. Adadevoh – *who did not participate in the negotiation sessions with Spotify* – Spotify rejected this [REDACTED] proposal, and [REDACTED]. *See* Trial Exs. 5264 at 4; 5265 at 2; 9/3/2020 5495-97 (Adadevoh). According to Warner, Spotify also rejected its subsequent proposal for [REDACTED]. Trial Ex. 4020 at 1.

In February 2017, Warner alternately proposed that, in consideration of a [REDACTED], Spotify [REDACTED]. However, Spotify refused. Trial Exs. 5520 at 2; 5038; 9/3/20 Tr. 5505 (Adadevoh).

Ultimately, Warner agreed to [REDACTED]. According to Ms. Adadevoh, Warner agreed to [REDACTED], motivated in part by [REDACTED]. SoundExchange avers that Warner's [REDACTED] was reasonable because Spotify had [REDACTED]. Trial Ex. 5401 at 3. In this regard, Ms. Adadevoh testified at the hearing that Warner's perception of Spotify's [REDACTED] 9/3/20 Tr. 5490-91 (Adadevoh). Accordingly, she testified that Warner [REDACTED]. 9/3/20 Tr. 5531 (Adadevoh).

⁴⁴ That [REDACTED] is discussed *infra*, section III.B.2, after the Judges consider the evidence regarding the negotiations between Spotify and Sony and between Spotify and Warner.

During these negotiations, Warner attempted to determine whether its speculation was justified that Spotify might have [REDACTED]. Through this analysis, Warner was [REDACTED]. Nonetheless, according to SoundExchange, Warner's [REDACTED], but rather reflected the [REDACTED]. SX PFFCL ¶ 435 (citing Trial Ex. 4014 at 1; 9/3/20 Tr. 5601-02 (Adadevoh)).

Ms. Adadevoh testified that – notwithstanding the [REDACTED] that Spotify had [REDACTED] – Warner [REDACTED]. Trial Ex. 5612 ¶ 12 (WRT of Reni Adadevoh); 9/3/20 Tr. 5530-31 (Adadevoh). The importance of [REDACTED] was noted in an email written by Warner's lead negotiator with Spotify, who wrote that "[REDACTED]" the effect on WMG's [REDACTED] would be [REDACTED]. Trial Ex. 2124 at 1. The same email also stated that the [REDACTED] in Warner's 2013 agreement with Spotify did not [REDACTED]. Trial Ex. 2124 at 1; Adadevoh WDT ¶ 12.

To underscore Warner's purported concern that Spotify might [REDACTED], SoundExchange also notes discussions on a Warner [REDACTED] regarding [REDACTED]. Trial Ex. 4025 at 1.

Ultimately, Warner agreed to [REDACTED], which was included in its 2017 Agreement with Spotify. Trial Ex. 5038; Adadevoh WDT ¶¶ 11-12. According to Ms. Adadevoh, Warner [REDACTED] because "[REDACTED]" 9/3/20 Tr. 5480.

The Services respond first by noting that SoundExchange has ignored the import of Warner's complementary oligopoly power in connection with the bargaining dynamics. Absent consideration of this fact, they argue that Ms. Adadevoh's assertion that [REDACTED] is simply conclusory and hardly credible. Additionally, the Services maintain that there is no evidence linking [REDACTED] to either 1) a [REDACTED] or 2) a [REDACTED].

The Services also assert that a key document on which SoundExchange relies, Trial Ex. 4022, actually identifies [REDACTED] in its 2017 Agreement with Spotify.⁴⁵ Among these drivers, according to the Services’ understanding of this Warner document, was [REDACTED]. *See* Trial Ex. 4011 at 1 (“[REDACTED]”).

The Services also note that another document on which SoundExchange relies regarding the Warner-Spotify negotiations, Trial Ex. 5264, consists of double hearsay – providing a second-hand report of Spotify statements. Moreover, the Services claim the statements contained therein cannot even unambiguously be attributed to specific sources – making it difficult to tell whether certain text reflects a Spotify statement, Ms. Gardner’s reaction thereto, or something else entirely. Moreover, the Services point out that the testifying Warner witness, Ms. Adadevoh, did not claim to have personal knowledge sufficient to provide the requisite clarity.

The Services also characterize as misleading SoundExchange’s attempt to portray [REDACTED] as an example of Spotify’s market power. Rather, they claim that an examination of Trial Ex. 5265 reveals that Spotify was [REDACTED] in the 2017 Agreement; rather, Spotify was making the practical observation that if a [REDACTED]. Trial Ex. 5265 at 4-5. And, the Services add, allowing a [REDACTED] noted *supra* in Trial Ex. 4011.

The Services also dispute SoundExchange’s assertion that Spotify’s refusal to provide Warner with [REDACTED] demonstrates Spotify’s increased bargaining or market power. They note that it was Spotify’s [REDACTED]. Moreover, the Services note that Warner made its proposal [REDACTED] (*see* Trial Ex. 5520) [REDACTED], belying Ms. Adadevoh’s suggestion that [REDACTED]. Additionally, the Services point

⁴⁵ The Services also identify several other “drivers” that led Warner to agree to the terms of the 2017 Agreement, predominantly relating to Warner’s [REDACTED]. These other points are discussed *infra*.

out that Trial Ex. 5520 also reveals that Warner sought to [REDACTED] — underscoring the degree to which Warner recognized that it, too, [REDACTED] — and that Warner was willing to agree to [REDACTED] because of [REDACTED]. *See* Trial Ex. 5520 at 3.

More broadly, the Services argue that, if it was true that Spotify had been [REDACTED], the negotiation files would have been [REDACTED], and yet, by contrast, the quantum of evidence on which Warner relies is remarkably slender. Services RPPFCL ¶ 434 (and record citations therein). And, with regard to the extant record evidence, the Services characterize as insufficient and unconvincing SoundExchange’s attempt to recharacterize Warner’s internal [REDACTED]. *See* Trial Ex. 4014. Continuing its attack on what it describes as SoundExchange’s purported misstatement of the evidentiary record, the Services point to another SoundExchange document, Trial Ex. 2124, which includes, [REDACTED] – contradicting SoundExchange’s argument that the [REDACTED] (as discussed *supra*).

Continuing its attack on the usefulness of the evidence relied upon by SoundExchange relating to Warner’s negotiations with Spotify, the Services note that Trial Ex. 4025, apparently describing [REDACTED] is replete with double hearsay, in the form of a declarant’s summary of third-party statements by other declarants. The Services state that there is no indication that any particular comment in this exhibit reflects Warner’s final or official position, or that they are not merely the opinions of each individual. On the substance of this exhibit, the Services point out that this document contains [REDACTED], ignored by SoundExchange, which [REDACTED]. Services RPPFCL ¶ 438 (and record citations therein).

The Judges find the Services’ arguments convincing. Warner’s internal correspondence indicates it was [REDACTED]. But, when it [REDACTED] Warner’s

contract with Spotify. On these facts, the Judges cannot find support for Spotify's supposed new-found power [REDACTED].

Further, there is no persuasive evidence [REDACTED] included in that contract. The Judges will not presume such a *[REDACTED]* when the record does not reflect that this [REDACTED] occurred. Alternatively stated, SoundExchange is asserting that the Judges should find causation – that the [REDACTED] and vice versa – when the evidence [REDACTED]. Here, the absence of testimony from the actual negotiators looms large; if there had been evidence of such [REDACTED] (which is not in the present record) in first-hand testimony from the negotiators, the Judges could have weighed their direct and cross-examination testimony to assist in making a finding as to this issue. But, no such record exists. Accordingly, the possibility that [REDACTED] were the consequence of Spotify's new market power [REDACTED] is not more plausible than the Services' position that the [REDACTED] were included, [REDACTED], to [REDACTED], and that Warner's agreement to the [REDACTED] was [REDACTED].

Additionally, the fact that Spotify refused to [REDACTED] Warner does not reflect any pricing power possessed by *Spotify*. Rather, *it reflects the power of [REDACTED] to [REDACTED], thus undermining price competition.*

Finally, the Warner [REDACTED] document on which SoundExchange relies is unpersuasive. Not only does it consist of double-hearsay—as the Services note, it also fails to identify the speakers and their business affiliations [REDACTED] (which also are not provided in hearing testimony)—but rather, the email reflects [REDACTED] regarding the pending Spotify-Warner 2017 Agreement. In that regard, it contains [REDACTED], allegedly voiced by the unidentified participants. As the Judges noted *supra*, corporate documents, including [REDACTED] are often likely to fail to shed light

on the economic factors relevant to a proceeding. *See William Inglis & Sons Baking*, 688 F.2d at 1028.

Here, the Warner [REDACTED] document is even more problematic, as it merely recites [REDACTED]. The problem with this document – *emblematic of the problem with all of these hearsay documents* – was highlighted in a fruitless attempt by SoundExchange’s counsel to cross-examine Professor Shapiro regarding the meaning of a double hearsay declaration in this Warner [REDACTED] document, Trial Ex. 4025. Presented with language in this exhibit stating: “[REDACTED]” Professor Shapiro responded by stating: “I’m not sure what this [REDACTED] means,” and adding: “I don’t know what it means [REDACTED].” 8/20/20 Tr. 3076-77 (Shapiro). The witness then asks SoundExchange’s counsel: “Could you help me out on that?,” to which SoundExchange’s counsel then had no choice but figuratively to throw up his hands and lament: “Well, ... *let's just leave it since we don't have the fact witness here.*” 8/20/20 Tr. 3077 (Shapiro) (emphasis added). The Judges share that frustration.

iii. The Sony-Spotify Negotiations

According to Sony, at the outset of negotiations, Spotify sought [REDACTED]. 9/2/20 Tr. 5218 (Piibe). However, Sony was [REDACTED] particularly because Sony believed the proposed [REDACTED]. Piibe WDT ¶ 20; 9/2/20 Tr. 5195-96 (Piibe); Trial Ex. 4018 at 1. The Services find this opening salvo – made about a year before the parties ultimately executed their 2017 Agreement – to be wholly unremarkable. Professor Shapiro characterizes this start to negotiations as merely “[REDACTED]” 8/20/20 Tr. 3082 (Shapiro).

When [REDACTED] appeared [REDACTED] Sony decided that, “[REDACTED],”⁴⁶ it would offer to [REDACTED]. Trial Ex. 5461 at 7, 35 (offering increasing [REDACTED]);⁴⁷ *see also* Trial Ex. 4026 at 1, 4 (offering a more general framework for [REDACTED]); Piibe WDT ¶ 22 (the thinking behind the [REDACTED] was simply that, [REDACTED]).

The Services’ rejoinder to this assertion is consistent with their explanation of the problem regarding the [REDACTED]: As long as Spotify remained [REDACTED], Spotify was [REDACTED] Services RPFCL ¶ 442 (and record citations therein).

Because Sony understood that Spotify had the [REDACTED], Piibe WDT ¶ 25, Sony recognized that a consequence of [REDACTED]. As Mr. Piibe explained, in [REDACTED]. Piibe WDT ¶ 26. Moreover, Sony asserted that it [REDACTED] – because it believed that Spotify could [REDACTED] Piibe WDT ¶ 26 (emphasis added).

More particularly, Sony asserts that it was concerned about Spotify’s [REDACTED]. *See* Trial Ex. 5451 at 1 (noting that Spotify [REDACTED]); Trial Ex. 5461 at 40 (noting that [REDACTED]); Trial Ex. 5514 at 3 (noting that [REDACTED] and identifying [REDACTED]); Trial Ex. 4017 at 4 (noting that [REDACTED]). Sony was concerned because it believed its [REDACTED] Trial Ex. 5461 at 40; *accord* Trial Ex. 5514 at 3 (asserting that Sony’s [REDACTED]). Trial Ex. 5468 at 2.

The Services aver that these purported [REDACTED] reflect mere possibilities, which Sony [REDACTED] in contract negotiations. First, regarding [REDACTED], the 2017 Agreement included a [REDACTED] More particularly, the Services note the

⁴⁶ The relevancy of Spotify’s “importance” to Sony and the other Majors, in terms of the subscription royalty rate [REDACTED], is discussed *infra*.

⁴⁷ To put this proposal in context, Sony’s market share for interactive subscription plays in 2018 was [REDACTED]%. Orszag WDT, tbl.2.

dynamics of the negotiations that led to [REDACTED]. In Spotify's initial contract proposal, Trial Ex. 5461, it sought a [REDACTED] However, in the final 2017 Agreement, Trial Ex. 5011, the [REDACTED] was [REDACTED] to Sony.

Moreover, the Services point to what they consider to be a blatant inconsistency between Mr. Piibe's WDT regarding this [REDACTED] and Mr. Piibe's deposition testimony in this proceeding, with which he was confronted at the hearing, as set forth below:

[Hearing Question]: [L]et me ask you to take a look at ... your deposition.
...

[Deposition Question]:

[REDACTED]?

* * *

[Deposition Answer]

[REDACTED].

[Hearing Question]

[W]as that answer correct at the time?

[Hearing Answer]

Yes.

9/2/20 Tr. 5339-40 (Piibe) (emphasis and bolding added).

Further, the Services note (as discussed *supra*) that the [REDACTED] in the Sony-Spotify 2017 Agreement contained a [REDACTED] Trial Ex. 5011 at 36. There is no basis in the record, the Services maintain, to conclude that this [REDACTED] would [REDACTED], two areas regarding which Sony claimed to be concerned.

SoundExchange also finds a [REDACTED] in a statement supposedly made by Spotify (contained in an internal Sony email), [REDACTED] There, Mr. Piibe recounted what he heard from a Sony employee regarding a statement allegedly made by a Spotify negotiator, to the effect that, [REDACTED]. Trial Ex. 5469 at 1. Mr. Piibe asserts that,

in response to that and [REDACTED], Sony “determined that [REDACTED]” Piibe WDT ¶¶ 24, 26.

The Services respond by noting that this [REDACTED] – of questionable veracity given the double-hearsay nature of its representations – [REDACTED]. Further, the Services contrast what they characterize as [REDACTED] with what they indicate to be Mr. Orszag’s [REDACTED] characterization of the statement in his oral testimony as a “[REDACTED]” in which Spotify said, “[REDACTED].” 8/12/20 Tr. 1743 (Orszag). Ultimately, Sony determined that it was [REDACTED] that, according to its testifying witness Mr. Piibe, caused a “[REDACTED].” Piibe WDT ¶ 23. According to Mr. Piibe, Sony, in fact, [REDACTED]. Piibe WDT ¶ 36. And, during the hearing, he elaborated, testifying:

[REDACTED].

9/2/20 Tr. 5228 (Piibe) (emphasis added). Moreover, on behalf of Sony, Mr. Piibe speculated that Spotify was [REDACTED]. 9/2/20 Tr. 5228, 5368 (Piibe). Consequently, Sony negotiators, according to an internal Sony e-mail, concluded that [REDACTED]. Trial Ex. 5467 at 1.

The Judges find, for several reasons, that the evidence proffered by SoundExchange regarding the Sony-Spotify negotiations does not support the assertion that Spotify’s supposed new pricing power was [REDACTED]. First, Spotify’s [REDACTED] was simply consistent with the [REDACTED]. Thus, such [REDACTED] was not [REDACTED].

Next, SoundExchange’s assertion that Sony alternatively sought [REDACTED] in order to [REDACTED] was unambiguously refuted by Mr. Piibe’s deposition testimony. As noted above, in that testimony, he admitted that [REDACTED]. His testimony in this regard also neutralizes the claim by SoundExchange that [REDACTED].

Finally, the Judges take note of Mr. Piibe’s exaggerated hearing testimony regarding Sony’s decision [REDACTED]. In that testimony, Mr. Piibe indicated that the very [REDACTED] was “[REDACTED]” to the point that he was “stuttering” in an attempt to “process” the idea. The Judges find this over-the-top testimony not only lacking in credibility, but also a fine example of the adage “the lady doth protest too much.”⁴⁸ Mr. Piibe was a polished witness who spoke carefully and with fluidity. The question that he was asked that led to his “stuttering” response was the following: “[REDACTED]?” 9/2/20 Tr. 5228 (Piibe).

This question was straightforward, simple, and posed to him on *direct* examination, thus unlikely to have caught him by surprise. Moreover, the [REDACTED] is the [REDACTED]. The Judges cannot fathom that a Major, a sophisticated corporation, would not [REDACTED] when it is undisputed in the present record, and supported by the economic analysis discussed in this Determination, that [REDACTED]. Indeed, a substantial component of SoundExchange’s case-in-chief (presented in the testimony of Professor Willig) turns on the contributions each party makes to the value of a music service and their fallback values.⁴⁹ What the Judges find inconceivable is Mr. Piibe’s claim that [REDACTED]. Thus, the Judges find this exaggerated testimony to lack credibility, indicating that there must have been another reason for [REDACTED].

⁴⁸ WILLIAM SHAKESPEARE, HAMLET act III, sc. 2.

⁴⁹ Professor Willig refers to the opportunity cost of a Major that is a complementary oligopolist when negotiating with a potential licensee as the [REDACTED] opportunity cost. [REDACTED]

**e. Other Record Evidence and Testimony Contradict SoundExchange's
Claim that Spotify's Pricing Power had Neutralized the Majors'
Complementary Oligopoly Power**

If Spotify, in fact, had become so powerful by virtue of its market size, ability to [REDACTED] and ability to [REDACTED], as a Sony executive wrote, to [REDACTED]. Trial Ex. 2137. However, the evidence indicates that the Majors were [REDACTED]. The Judges find telling the following colloquy between the bench and Michael Sherwood, a senior Warner executive:

[THE JUDGES]

[REDACTED]?

[MR. SHERWOOD]

[REDACTED]....

[THE JUDGES]

Why [REDACTED]?

[THE WITNESS]

[REDACTED].

[THE JUDGES]

Okay. Did you have an understanding as to why [REDACTED]?

[MR. SHERWOOD]

I [REDACTED].

[THE JUDGES]

When you say [REDACTED], you mean [REDACTED], so to speak?

[MR. SHERWOOD]

Correct. That was my impression of it.

[THE JUDGES]

Okay. And how did you come to that impression?

[MR. SHERWOOD]

Through conversations with our business development team at Warner Music Group.

[THE JUDGES]

Okay. Who, in particular, do you recall, by name?

[MR. SHERWOOD]

I don't, unfortunately. That team has had some turnover since that time.

[THE JUDGES]

I see. Who was the head of the team at the time you came to that conclusion?

[MR. SHERWOOD]

[REDACTED].

* * *

[THE JUDGES]

Okay. And at a more general level, separate and apart from this particular negotiation and [REDACTED], how would you [REDACTED]?

[MR. SHERWOOD]

Well, if that circumstance were to come to light, [REDACTED].

9/9/20 Tr. 5930-32 (Sherwood) (emphasis added).

The Judges find Mr. Sherwood's testimony, quoted at length above, to be highly informative, and the Judges found him to be a highly credible witness. He has been a Warner employee for 21 years, and he is currently the Senior Vice President of Streaming and Revenue, responsible for overseeing all of the revenue-generating commercial accounts, which include digital service providers, including Spotify. 9/9/20 Tr. 5912-13 (Sherwood). Moreover, he was one of the few Major employees that SoundExchange chose to testify in this proceeding, out of the numerous individuals who had duties related to the streaming services or who wrote or received emails regarding the issues raised in the present proceeding.

His testimony indicates that [REDACTED] what the Services have argued repeatedly – that *Spotify* [REDACTED] when it [REDACTED]. Not only did Mr.

Sherwood agree with that [REDACTED], but he also identified the negotiating team within Warner itself as having informed him that [REDACTED] This testimony supports the Services' characterization of Spotify's weak pricing power and overall bargaining position, further confirming the dubiousness of SoundExchange's claim that the Majors did not [REDACTED] that [REDACTED] continued into the negotiations over the 2017 Agreements.

Perhaps even more importantly, Mr. Sherwood's testimony regarding [REDACTED] speaks even more persuasively than his words. Warner was [REDACTED], as he testified he would do if a [REDACTED].

Mr. Sherwood's testimony also underscores the problem created by SoundExchange's decision not to call witnesses with first-hand experience negotiating with Spotify, such as [REDACTED], who could have shed direct light on the Majors' analysis of Spotify's [REDACTED] in the 2016–2017 period.⁵⁰

Finally, Mr. Sherwood's testimony [REDACTED] gives real-world evidence of the substitutability and cross-elasticity of these various downstream services addressed by the Services' economic expert witnesses. Likewise, this testimony shows [REDACTED], consistent with SoundExchange's direct case criticisms of Pandora's Label Suppression Experiments for their failure to address how the industry would respond to such a going-dark scenario.

One of SoundExchange's internal Major documents from an executive who actually negotiated with Spotify took a [REDACTED] than SoundExchange regarding

⁵⁰ This portion of Mr. Sherwood's testimony does not contain inadmissible hearsay, as it is in the nature of testimony regarding an admission and/or declaration against interest by Warner. Moreover, no objection was lodged by SoundExchange (which would have been awkward, given that he was its own witness and the testimony had been elicited by the Judges) and, even if the testimony constitutes hearsay, the Judges invoke their discretion to allow hearsay testimony pursuant to 37 CFR 351.10(a).

Spotify's pricing power – [REDACTED] consistent with the Judges' findings herein that Spotify had not acquired pricing power sufficient to [REDACTED]. The document was an email written by [REDACTED] 9/2/20 Tr. 5247 (Piibe). Mr. [REDACTED] wrote the following in a December 13, 2016 email — [REDACTED] in a response to [REDACTED]:

[REDACTED]

[REDACTED]

[REDACTED]

[REDACTED].

Trial Ex. 5467 (emphasis and bolding added).

In the succinct, colloquial, and mildly vulgar statement emphasized above, Mr. [REDACTED] concisely summed up [REDACTED] The Judges find Mr. [REDACTED] observation consistent with the economic analysis on which the Judges have relied in this Determination, supporting the finding that Spotify lacked the pricing power to mitigate or offset the complementary oligopoly power of the Majors.

But, as the quoted document — indeed, the quoted sentence — *also* reveals, Mr. [REDACTED] took note of [REDACTED], stating that he “[REDACTED]” Trial Ex. 5467. Thus, Mr. [REDACTED], in one sentence, also summed up a conundrum that is at the heart of the question: Why did three complementary oligopolists decline to exercise their market power [REDACTED]?

The Judges consider that conundrum below.⁵¹

⁵¹ SoundExchange notes that Apple has [REDACTED]. Moreover, it notes that Apple [REDACTED] [REDACTED]. 9/3/20 Tr. 5681-82 (Harrison); Harrison WDT ¶ 31. Subsequently, Apple also [REDACTED]. Piibe WDT ¶ 46. *See generally* 8/13/20 Tr. 1899-1900 (Orszag); 8/11/20 Tr. 1367

2. The Majors' Action to [REDACTED]

a. Introduction

The record discussed *supra* reflects an apparent disconnect between the facts discussed above and the relevant economic principles. The Majors agreed to [REDACTED]. Why did that occur? The upstream benchmark agreements at issue were consummated in a market where the licensors, the Majors, are complementary oligopolists with “Must Have” repertoires, and the licensee, Spotify—despite being

(Orszag). According to SoundExchange, these facts indicate that Apple, [REDACTED] was able to [REDACTED]. See SX PFFCL ¶ 468 (and record citations therein).

However, the Judges are struck by the fact that the record regarding Apple's relationship with the Majors is barren, even in comparison to the meager and disjointed proofs SoundExchange proffered regarding Spotify's negotiations with the Majors. There are no internal documents from the Majors describing their relationship with Apple, including [REDACTED], nor is there any evidence that Apple [REDACTED]. *Accord*, Services' Response to SX PFFCL ¶ 466 (noting the [REDACTED] the setting and level of its rates). Moreover, as the Services note, Mr. Orszag did not use the Apple rate as a benchmark in this proceeding. *Id.* ¶ 465. In fact, Mr. Orszag did not identify in the materials upon which he relied in preparing his WDT any documents memorializing any aspect of Apple's negotiations with any of the Majors, and he could not recall with any certainty having reviewed such documents prior to preparing that written testimony. 8/12/20 Tr. 1646-48 (Orszag)..

The Judges also note that the fact that Apple [REDACTED] is consistent with the Judges' understanding of the Majors' [REDACTED]. That is, the Majors negotiated [REDACTED], so to speak.

For these reasons, the Judges find that there is insufficient evidence that Apple's [REDACTED] is supportive of SoundExchange's argument that an interactive service's mere market share [REDACTED]. (The Judges note that this is not the first time the Judges have declined to give weight to SoundExchange's underdeveloped record as it related to an Apple agreement. See *Web IV*, 81 FR at 26352 (declining to rely on “SoundExchange's analysis and use of [an] Apple agreement” because “there is insufficient evidence in the record”)).

arguably the largest interactive service—lacked long-term bargaining power and pricing power sufficient to affect, let alone dictate, the terms of trade.⁵²

The further factual record though, when analyzed through the lens of economics, provides the answer to this facial conundrum; the Majors were intent on surviving as powerful licensors vis-à-vis their licensees.⁵³ As discussed below, the Majors were [REDACTED], enabling them to [REDACTED].⁵⁴ One way the Majors could attempt to

⁵² To better appreciate the Judges’ discussion of this conundrum, they note here a distinction among different types of economic power as used in this analysis.

The Judges use the phrase “pricing power” to reflect the ability of a seller or buyer (or licensor or licensee) to influence price (royalty rates) because of its own “market power,” arising from strengths, such as monopoly, monopsony, oligopoly, or oligopsony positions, as derived from whatever source. Here, the Majors have “pricing power” derived from their status as complementary oligopolists; Spotify lacked “pricing power,” for the reasons discussed *supra*.

The Judges use the phrase “countervailing power,” as discussed *supra*, to reflect a contracting party’s power, again from whatever source, that offsets, in whole or in part, the pricing power of a counterparty. (Thus, it is a power defined in relative terms compared to the opposing commercial power.).

These two types of power collide in the negotiation process, allowing each party to exert a measure of “bargaining power.” See Orszag WDT ¶ 110 (and citations therein) (“Bargaining power can be defined as the advantage one player has over another in establishing desired terms [and] can arise from a number of sources, including market power, better information (*e.g.*, knowledge of the true value of what is being negotiated), and credible threats to retaliate or steer business away from the other player. A player with enhanced bargaining power tends to extract greater surplus through better terms.”).

⁵³ See MANNE & WILLIAMSON, *supra* at 620 (“In the end, whatever business people *think* they are maximizing, whatever they do or wish to do, *survival is ultimately an economic matter.*”) (emphasis added).

⁵⁴ Despite their complementary oligopoly power, the [REDACTED] is a contemporary example of the literary adage: “Uneasy lies the head that wears a crown.” William Shakespeare, *King Henry IV*, act III, sc. 1. From the drier economic perspective, the [REDACTED].

avoid this development and survive as economically powerful licensors was to [REDACTED] that were rapidly expanding in the interactive market.

Accordingly, as the record (discussed below) reveals, [REDACTED], the Majors [REDACTED] in order to [REDACTED].⁵⁵

The Judges' evidence-based analysis in this section is not the story that SoundExchange chooses to emphasize. SoundExchange prefers the story in which the Majors are the [REDACTED]. It is not immediately obvious why SoundExchange prefers that story to the facts that actually match economic theory to reality—that the Majors perceived themselves as [REDACTED].⁵⁶

The forgoing analysis is also not the story told by the Services. Although they discuss the same record facts as relied upon by the Judges (discussed *infra*), they aver that these facts demonstrate merely that the Majors were behaving as complementary oligopolists always behave—[REDACTED], without regard for the bargaining power of their counterparties. As explained in more detail *infra*, the Services' understanding of the facts is neither supported by the record nor relevant to the Judges' task of identifying an effectively competitive rate.

⁵⁵ An IPO is a process offering shares of a private corporation to the public in a new stock issuance that allows the corporation to raise capital from public investors. *See* Investopedia.com (search term “Initial Public Offering”) (last accessed May 12, 2021). Ultimately, Spotify decided to forego an IPO and instead engaged in a “Direct Placement” (a/k/a “Direct Public Offering” or “Direct Listing”) by which the corporation does not raise new capital, but rather enables its existing shareholders to sell their stock to the public. *See Spotify's Wall Street Debut is a Success*, New York Times (Apr. 3, 2018); *See generally* Corporatefinanceinstitute.com (search term “Direct Placement”) (last accessed May 14, 2021).

⁵⁶ It may be that SoundExchange was reluctant to emphasize a countervailing power argument that was not based on a licensee's pricing power because pricing power (through steering) was the rationale applied in *Web IV*.

b. The Majors' [REDACTED]

Nested within its assertions of Spotify's pricing power, *discussed supra*, SoundExchange presented witness testimony and advanced arguments that the [REDACTED]—in the interactive service market.⁵⁷ Some of the most compelling testimony in this regard was provided by Aaron Harrison, Universal's Senior Vice President, Business & Legal Affairs, responsible for overseeing the teams that negotiate licensing agreements with digital music services. Harrison WDT ¶ 1.

In his written direct testimony, Mr. Harrison emphasized the [REDACTED]:

[S]ome on-demand services are part of companies that dwarf [Universal] and dominate digital markets. Amazon, Apple and Google, for example, can rely on their size to absorb any losses from their streaming services *and* [REDACTED].

Id. ¶ 41 (emphasis added); *see also* Orszag WDT ¶ 39 n.56 (relying on a 2019 trade publication article stating that Amazon Music is reportedly growing faster than Spotify and Apple Music).⁵⁸ At the hearing, Mr. Harrison elaborated on this [REDACTED]. 9/3/20 Tr. 5752 (Harrison) (acknowledging that Universal's [REDACTED]).

The relevance of the *size* of the tech firms must be distinguished from the *market* power of a Must Have Major. The latter has what Professor Willig aptly describes as “walk away” *market* power, *see* Trial Ex. 5600 ¶ 14 (CWDT of Robert Willig) (Willig

⁵⁷ The rapid rise of the tech firms in the interactive market is undisputed. The record reveals that [REDACTED], account for [REDACTED] of U.S. interactive subscribers respectively, and [REDACTED] has already [REDACTED]. Orszag WDT, tbl.4.

⁵⁸ As noted above, SoundExchange does not emphasize this argument. In this regard, Mr. Harrison buries this [REDACTED] in a section of his WDT entitled, “[REDACTED],” Harrison WDT at 12, where he notes there are “several reasons” why [REDACTED]. But the fourth (and final) reason he provides, the one addressed in the accompanying text, *see id.* ¶ 41, pertains *only* [REDACTED]. Thus, this final reason resides as something of a non sequitur within a section explaining why Mr. Harrison believed [REDACTED].

WDT), in that a service cannot operate when it lacks a license for the sound recordings from each of the three Majors. Therein lies the power of ownership and control over essential inputs possessed by complementary oligopolists. The tech firms, however, possess a different type of power. Their advantage is based on *sheer size*, affording them the potential to dominate a market they decide to enter.⁵⁹ Thus, if they were to control the downstream interactive streaming market [REDACTED], they would be well-positioned to threaten blacking out one (or more) Majors and to follow through on that threat by, as Mr. Harrison testified, [REDACTED]. *See* SX PFFCL ¶ 336 (“the music business is a rounding error for these big-tech services.”).⁶⁰

Accordingly, [REDACTED]. As Mr. Harrison further acknowledged on cross-examination, it was his view that “[REDACTED]” 9/3/20 Tr. 5721 (Harrison).

⁵⁹ This distinction between market power and power derived from sheer corporate size is a specific example of a broader contemporary issue in competition law, especially with regard to these tech firms. *Compare* TIM WU, *THE CURSE OF BIGNESS* 15, 21 (2018) (asserting that the power of “just a handful of giants ... *Amazon, Google and Apple ... transcend[s] the narrowly economic*”) with J. Wright *et al.*, *Requiem for a Paradox: The Dubious Rise and Inevitable Fall of Hipster Antitrust*, 51 *Az. St. L.J.* 293, 362 (2019) (criticizing the new emphasis on sheer corporate size as “call[ing] for nothing less than the complete dismantling of the consumer welfare standard and the consensus ... among antitrust practitioners, enforcers and academics ... about how to promote competition.”).

⁶⁰ The ability of tech firms to dominate markets, including music markets, and the implications of that power has been noted by economists who have studied the issue. *See* ALAN B. KRUEGER, *ROCKONOMICS* at 103, 200-201 (2019) (“Superstar firms, including *Google, Apple and Amazon*, have probably benefited from ... deploying the technological innovations that enable them to take advantage of enormous economies of scale [b]ut there is also a concern that such firms use their dominant position to stifle competition. ... Spotify’s long-run existential challenge is exacerbated by the fact that [tech firms] can sustain losses ... *rais[ing] the question of whether Spotify can be sustainable as a stand-alone company.*”) (emphasis added).

Moreover, Mr. Harrison agreed that the economic [REDACTED] would not only [REDACTED], but also would “[REDACTED].” 9/3/20 Tr. 5721 (Harrison).

The Services do not dispute that the Majors [REDACTED]. In fact, relying on Mr. Harrison’s testimony, the Services argue that the Majors [REDACTED]

[to] [REDACTED]

Services PFFCL ¶ 147.⁶¹ The Services argue that this testimony reveals that “[t]he unmistakable implication of Mr. Harrison’s testimony [is that Universal] [REDACTED] Services PFFCL ¶ 147.

The Judges find that the Services misconstrue the import of this aspect of Mr. Harrison’s testimony. His point is [REDACTED]. (In fact, [REDACTED] make that apparent. *See* Orszag WDT tbls.15 & 16.). Rather, the point is that the [REDACTED] would [REDACTED] would [REDACTED]. For example, [REDACTED]. *See generally* J. Baker & J. Farrell, *Oligopoly Coordination, Economic Analysis, and the*

⁶¹ The idea that [REDACTED]. In *Web II*, 72 FR 24084 (2007), the Judges set rates for all noninteractive services at \$0.0008 for 2006, rising annually to \$0.0019 in 2010, after a hearing that included the large tech services of that era—Yahoo, Microsoft, and AOL. After the passage of the Webcaster Settlement Acts of 2008 and 2009, SoundExchange negotiated a substantially *lower* per-play royalty rate regime for the pureplay noninteractive services—beginning at the same \$0.0008 for 2006, but then lower in every subsequent year until reaching a 2010 rate of \$0.00097, only 51% of the *Web II* rate. (The pureplay rate was part of a greater-of structure including a 25%- of-revenue prong, but that prong was not triggered.). In addition, the pureplay settlement rates continued through 2015 and were substantially lower than the *Web III* rates. For example, in the final year of the *Web III* rate period (2015), the pureplay rate was \$0.0014, only 61% of the *Web III* rate of \$0.0023 (with similar disparities in the prior years of the *Web III* rate period). The Webcaster Settlement Acts prohibited a party from using the settlement rates as precedent or evidence in subsequent proceedings. *See generally* Jeffrey A. Eisenach, *The Sound Recording Performance Right at a Crossroads: Will Market Rates Prevail?*, 22 COMMLAW CONSPECTUS 1 (2014).

Prophylactic Role of Horizontal Merger Enforcement, 168 U. Pa. L. Rev. 1985 (1986).

Thus, [REDACTED].⁶²

Whether [REDACTED] generates an effectively competitive rate *in the interactive benchmark market* is of no consequence in this proceeding regarding *the noninteractive market*.⁶³ Rather, *the important issue for the present benchmarking purposes is whether the royalty rate the Majors agree to accept from Spotify is less influenced, on balance, by the complementary oligopoly power of the Majors [REDACTED]*.

Mr. Harrison’s testimony clearly shows that [REDACTED]. This is the economic reality that spawned Spotify’s bargaining power—a reality created by Spotify’s successful 2011 entry into the U.S. market. That is, it is a power that Spotify created, not merely a marketplace factor that the Majors, as complementary oligopolists, chose to exploit. Further, this particular bargaining power cannot be characterized and explained

⁶² The Services also construe Mr. Harrison’s testimony as [REDACTED] at “market segmentation.” Services PFFCL ¶ 147. However, market segmentation in the music streaming markets is typically undertaken to effectuate price discrimination. There is no sufficient evidence that is occurring here. The record does not indicate that Apple, Amazon, Google, and Spotify compete among themselves by each appealing principally to different segments of the listening public based on the varying willingness-to-pay among listeners (although each has tiers and products intended to appeal to categories of listeners varying based on willingness-to-pay).

⁶³ [REDACTED]). *See generally* David T. Scheffman & Richard S. Higgins, *Twenty Years of Raising Rivals’ Costs: History Assessment, and Future*, 12 GEO. MASON L. REV. 371, 375 (2003). An economist who specializes in the analysis of music markets has noted that licensees and licensors have the power to strategically manipulate relative streaming royalty rates. Kristelia A. Garcia, *Facilitating Competition by Remedial Regulation*, 31 BERKELEY TECH. L.J. 183, 221 (2016) (“the owners of popular songs ... acting alone or in tacit collusion with similarly situated entities [can] act anticompetitively by ... offering favorable rates to one service over another.”).

away like SoundExchange's other attempts to explain Spotify's bargaining power—

[REDACTED]. Quite the contrary: [REDACTED]⁶⁴ [REDACTED]

Mr. Harrison's testimony as considered above was echoed by Mr. Piibe, Sony's principal witness. Relying on Mr. Piibe's written testimony, SoundExchange argues as follows:

If Spotify was out of the market, record companies would have faced a material reduction in their relative bargaining power with other services.... [REDACTED].

SX PFFCL ¶ 333 (quoting Piibe WDT ¶ 48) (emphasis added).⁶⁵

⁶⁴ Tech firm dominance would not necessarily be limited to the exertion of their power in vertical negotiations with the Majors. The tech firms could integrate upstream and develop their own record companies and poach artists from the Majors. Such an event is not unlikely, given that 1) Amazon has already integrated upstream to create or purchase television and film content through Amazon Studios, 2) Apple has already integrated upstream with original content television shows, movies and documentaries available via Apple TV, and 3) Google has made a similar foray, through YouTube Originals. *See generally* <https://www.fastcompany.com/3058507/apple-facebook-google-and-alibaba-take-hollywood> (accessed June 2, 2021). Further, there is historical precedent for downstream distributors integrating upstream to compete with licensors, such as in 1939, when the NAB, representing radio station licensees, created Broadcast Music, Inc. (BMI) in the mid-20th century to compete with ASCAP, the dominant musical works licensor, after the latter sought a substantial increase in royalty payments. *See*, <https://www.bmi.com/about/history> (accessed June 2, 2021).

⁶⁵ [REDACTED] Mr. Piibe's testimony, repeated by SoundExchange, [REDACTED], the Judges do not credit other portions of that testimony. Specifically, the Judges do not agree that, in the context of vertical negotiations involving complementary oligopolists, [REDACTED], complementary oligopolists prefer multiple downstream licensees whose competition, *inter se*, allows the complementary oligopolists to avoid "double marginalization" (oligopolistic profits shared by upstream licensors and downstream sellers) and thus to capture for themselves the entirety of the supranormal profits generated by their market structure. *See Web IV*, 81 FR at 26342 & n.98 (Professor Katz testifying that "actually, *the more intense the competition downstream, the greater the incentive to charge a high price upstream* because you don't have

SoundExchange also makes this bargaining point, in the form of a response to Professor Shapiro's argument that the Majors should have instead gone on offense, using their complementary oligopoly power "[REDACTED]." 8/20/20 Tr. 3102-04 (Shapiro). In response to this argument, SoundExchange convincingly stated:

Had record companies leveraged their must-have status to walk away from Spotify, as Professor Shapiro suggests they were willing to do, Spotify's exit would have strengthen[ed] Apple Music significantly, and also strengthen[ed] Amazon and Google. [REDACTED].

SX PFFCL ¶ 335 (citing 8/11/20 Tr. 1273-75 (Orszag); Orszag WDT ¶ 33, tbl.4; 9/3/20 Tr. 5733 (Harrison) (emphasis added)).

To illuminate further how Spotify's role as a bulwark against the tech firms influenced the Majors' bargaining position with Spotify, SoundExchange states:

Put simply, leveraging must-have status to put Spotify out of business would risk making Apple Music dominant in the market. [REDACTED], the result would be a material increase in their relative bargaining power. The outcome would put the record companies in a precarious position, given that *the music business is a rounding error for these big-tech services*.

SX PFFCL ¶ 336 (citing 8/11/20 Tr. 1273-75 (Orszag); 9/3/20 5733 (Harrison) (emphasis added)). *See also* 8/11/20 Tr. 1274-75 (Orszag) (noting that the absence of Spotify would

to worry about so-called double marginalization) (emphasis added). Also, Mr. Piibe oddly omits from his list of benefits arising from a better Sony bargaining position its ability to increase its own profits—listing only artist income and investment recoupment as the benefits of a more advantageous bargaining environment. It is curious when a businessman fails to identify his company's own ability to increase profits as a worthy goal, as if acknowledging a desire to maximize profits is somehow inappropriate, so it is better to be disingenuous than disreputable. And, in that vein, Mr. Piibe joins in the Orwellian language of several of the Majors' other fact witnesses—identifying their streaming service counterparties as their "partners." Parties seeking to promote their own interests at the expense of their counterparties is a fundament of negotiation to be anticipated and welcomed, but the counterparties are hardly "partners." (Although in the context of [REDACTED] the Judges find it appropriate to note that the [REDACTED]).

increase the market shares of the tech firms).⁶⁶ SoundExchange’s point is reasonable.

Indeed, given that the record makes it clear [REDACTED].

c. The Majors Demonstrated [REDACTED]

Early in the negotiations, the [REDACTED]. Mr. Harrison’s further testimony on behalf of SoundExchange and Universal, in colloquy with the Judges, made that clear:

The Judges: [W]as it your understanding that [REDACTED]?

Mr. Harrison: [REDACTED]

9/3/20 Tr. 5748 (Harrison) (emphasis added).

The documentary evidence regarding the negotiations between Spotify and the Majors, relied on by SoundExchange, is consistent with the testimony considered above. More particularly, this evidence also reveals that [REDACTED].⁶⁷

In an email to Stefan Blom, Spotify’s then Chief Strategy Officer, dated December 7, 2016—approximately one-half year prior to the execution of the Spotify-Sony 2017 Agreement—Sony’s President, Global Digital Business & U.S. Sales, Dennis Kooker, wrote:

⁶⁶ More precisely, using Mr. Orszag’s subscriber data, if Spotify left the market and its subscriber share was distributed proportionately among its existing competitors, [REDACTED] See Orszag WDT, tbl 4. Alternatively, if Spotify were to be acquired by another large tech firm (*e.g.*, Facebook) and no longer be “independent,” then adding Spotify’s share to the existing tech firm shares would place [REDACTED]% of the interactive subscription in the hands of the large tech firms.

⁶⁷ [REDACTED] Spotify with a countervailing power that generated a more level bargaining table, in contrast to the one-sided bargaining where a “Must Have” Major could threaten—in Professor Willig’s terminology—to “walk away” from the negotiations. This change explains why the [REDACTED] other terms resulted in [REDACTED], as discussed *infra*.

[REDACTED].

Trial Ex. 4026 (emphasis added).⁶⁸ *See also* SX PFFCL ¶ 441 (acknowledging that Trial Ex. 4026 [REDACTED]).⁶⁹ And, as testified to by Mr. Piibe (who reported to Mr. Kooker), Spotify requested [REDACTED]s. 9/3/20 Tr. 5323 (Piibe). Thus, from the [REDACTED] that the former [REDACTED] through, *inter alia*, [REDACTED].

As generally acknowledged by Mr. Harrison's testimony, discussed *supra*, Universal's internal documents [REDACTED]. Eight months before the parties concluded negotiations and entered into the April 2017 Agreement, Johnathan Dworkin, Universal's Senior Vice President of Digital Strategy and Business Development, wrote the following in an internal email to other Universal executives dated August 27, 2016: [REDACTED] Trial Ex. 4023. *See also* SX PFFCL ¶ 473 (SoundExchange conceding that in Trial Ex. 4023 [REDACTED].”).

In a subsequent internal email to other Universal executives dated September 4, 2016, Jeffrey Harleston, Esq., Universal's General Counsel and Executive Vice President of Business & Legal Affairs, wrote the following—still *seven month prior* to the execution of Universal's 2017 Agreement with Spotify:

[REDACTED].

⁶⁸ Mr. Kooker testified in *Web IV*. SoundExchange did not call him as a witness in this *Web V* proceeding.

⁶⁹ The Judges understand the Majors' expressed interest in a [REDACTED] to be a specific example of how the Majors' could [REDACTED]. It is also true, as the Services point out, the record reflects that the [REDACTED] (and the ultimate Direct Placement [REDACTED]). *See* <https://seekingalpha.com/article/4408328-direct-listing-explained> (accessed June 2, 2021). However, there is no record evidence regarding the cost (including opportunity cost) incurred by the Majors to [REDACTED], so the Judges cannot find sufficient evidence that the Majors' [REDACTED] was an independent or material motive for [REDACTED]. *See also* Services PFFCL ¶ 144 (*the Services* acknowledging that Spotify's [REDACTED] (emphasis added)).

Trial Ex. 5421 (emphasis added).⁷⁰ In this exhibit, Mr. Harleston added that the [REDACTED] Trial Ex. 5421. As discussed further *infra*, the Judges find Spotify's [REDACTED] to be consistent with [REDACTED].

Rounding out the early documentary evidence, the third Major, Warner, in internal notes written by its chief Spotify negotiator, Tracey Gardner, dated October 12, 2016—*eight months out from the eventual Warner-Spotify 2017 Agreement*—recorded Spotify's [REDACTED]” Trial Ex. 4022 (emphasis added). According to these notes, Warner conveyed [REDACTED] Trial Ex. 4022 (emphasis added). Thus, Warner, [REDACTED], had indicated to Spotify early in the negotiations that [REDACTED].⁷¹

As negotiations proceeded, [REDACTED] remained an important element [REDACTED]. Specifically, in a December 13, 2016 internal Universal email, Trial Ex. 4052, written [REDACTED] of the Universal-Spotify 2017 Agreement, Universal's Michael Nash, Executive Vice President of Digital Strategy, included a draft⁷² letter to Spotify that stated the following:

⁷⁰ Mr. Harleston, also, testified in *Web IV*, but SoundExchange did not proffer him as a witness in this proceeding.

⁷¹ As the quoted language provides, Warner indicated that there was [REDACTED]. Although that point is self-evident and economically rational, stating so in negotiations is obviously strategically prudent. But the salient point here is that [REDACTED]—*thus allowing Spotify to negotiate on a more level playing field than would otherwise exist when it lacked such countervailing power in negotiations with a Must Have Major*.

⁷² Although the letter is identified in the email as a draft, SoundExchange does not claim that correspondence containing this or substantively similar language was not in fact transmitted to Spotify. See SX RPFCL (to Services) at 83 n.35 (noting the correspondence within Trial Ex. 4052 is identified as a draft but not denying it was sent to Spotify). Clearly, SoundExchange and Universal could have provided

[REDACTED].

Trial Ex. 4052 (emphasis added). This language not only *re-affirms* Universal's [REDACTED], it also *strongly emphasizes* the importance to Universal of [REDACTED].

In sum, the Judges find that the negotiation-related documents and testimony⁷³ show [REDACTED].⁷⁴

documentary evidence and/or testimony in an attempt to demonstrate the draft correspondence (or its sum and substance) had not been transmitted to Spotify. Because SoundExchange did not present such evidence or testimony, the Judges find that this correspondence, or a substantively similar version, was transmitted by Universal to Spotify.) In any event, this draft email demonstrates Mr. Nash's state of mind regarding the importance to Universal of [REDACTED]

⁷³ *These* business documents are probative because they provide facts relating to the parties' state of mind during negotiations that are [REDACTED]. See MANNE & WILLIAMSON, *supra* at 626-627 ("business documents can be useful in demonstrating 'economic realities' [that are] relevant ... [and] it is "permissible to ... consider evidence of intent, belief, or motivation to demonstrate that the act intended did, in fact, happen.).

⁷⁴ In an attempt to explain away the statements made by the Major's executives contained in the documents discussed above—[REDACTED]—SoundExchange asserts that these statements are [REDACTED] For example, [REDACTED] testified that [REDACTED]." [REDACTED] instead [REDACTED] 9/2/20 Tr. 5265 (Piibe); SoundExchange's Corrected Replies to the Services' Joint Proposed Findings of Fact and Conclusions of Law ¶ 145 (SX RPFCL (to Services)). See also SX RPFCL (to Services) at 81 nn.30, 33, 35; SX PPFCL at 147 n.17, ¶ 441 (multiple assertions by hearing *witnesses* that [REDACTED]). This argument highlights the serious defect in SoundExchange's failure to call as witnesses the negotiators and executives identified in the Majors' documents, who are the individuals who could testify as to their own state of mind when making those statements. Moreover, if these declarants [REDACTED] For these reasons, the Judges afford no weight to any testimony by SoundExchange witnesses who offer hearsay or opinion testimony regarding the so-called "true meaning" of statements made by declarants contained in the documentary record.

**d. The Services' Contrary Explanation of the [REDACTED] as Based
Solely on the Majors' Complementary Oligopoly is Unavailing**

The Services do not acknowledge this countervailing power argument. Rather, they attempt to explain away Spotify's value and power—[REDACTED]—by treating that phenomenon as purely the consequence of the Majors' complementary oligopoly power.

In this regard, the Services assert that the [REDACTED] was merely the [REDACTED]—telltale behavior of a complementary oligopolist rather than a price competitor. They rely on testimony by Messrs. Harrison and Orszag that Universal [REDACTED] not to [REDACTED], but rather [REDACTED]. Services PFFCL ¶ 148 (and record citations therein). The Services also cite testimony by Professor Shapiro in which he opines that when licensors are [REDACTED] 8/19/20 Tr. 2881 (Shapiro) (emphasis added). This basic principle, according to the Services, explains why “[REDACTED]” Services PFFCL ¶ 149 (citing 8/19/20 Tr. 2864, 2870, 2880 (Shapiro)) (emphasis added).

SoundExchange asserts there is a serious flaw in this reasoning, which undermines the Services' assertion that the Majors' complementary oligopoly status explains the sum and substance of the relative bargaining power of the Majors and Spotify. Specifically, SoundExchange avers that if the Majors were [REDACTED] they would have [REDACTED]. However, the record indicates that the Majors only negotiated [REDACTED].⁷⁵ In support of this point, SoundExchange refers to particular testimony by Professor Shapiro in a colloquy with the Judges. When asked by the Judges

⁷⁵ Apparently, [REDACTED], 9/3/2020 Tr. 5681-82 (Harrison), but that is not the same as a Major [REDACTED] as complementary oligopolists, in accordance with the Services' theory of the case. The Judges address the paucity of the record relating to this [REDACTED], *supra* note 51.

why the Majors [REDACTED]—given that [REDACTED]—Professor Shapiro responded, [REDACTED] 8/19/20 Tr. 2880 (Shapiro) (emphasis added).

The Judges agree with SoundExchange and find Professor Shapiro’s response unpersuasive. His theory of complementary oligopoly as the single cause of the [REDACTED] is premised on the idea that it was [REDACTED]—at monopoly rates rather than complementary oligopoly rates. 8/19/20 Tr. 2880-81 (Shapiro). But, if it was [REDACTED], there would have been no need [REDACTED]; rather, in their own interest the Majors would have [REDACTED]. Moreover, SoundExchange is persuasive in its argument that because the Majors [REDACTED], a fact acknowledged by Professor Shapiro, *see* Shapiro WRT at 23, fig. 1; 8/20/20 Tr. 3108-09 (Shapiro), the [REDACTED].

Alternatively, Professor Shapiro noted that Spotify may have [REDACTED] because it was the “leader” among interactive services. But the Judges find the record to demonstrate, as discussed above, that Spotify’s “leader” status was important because it was the leader among [REDACTED]. Google’s economic expert witness, Dr. Peterson, though, did acknowledge the importance of [REDACTED], testifying that [REDACTED] 8/25/20 Tr. 3723 (Peterson).⁷⁶

⁷⁶ By contrast, it is not clear that Professor Shapiro had recognized, acknowledged or recalled the importance of Spotify’s [REDACTED], until the Judges brought the issue to his attention. *Compare* 8/19/20 Tr. 2882 (Shapiro) (stating in response to the Judges’ inquiry that he did not recall reviewing correspondence indicating that [REDACTED]) *with* 8/20/20 Tr. 3080 (Shapiro) (Professor Shapiro testifying the next hearing day that it was his “sense” that because Spotify was [REDACTED] the Majors “[REDACTED].”) *and* Shapiro WRT at 18 n.58 (Professor Shapiro quoting from Sony’s December 7, 2016 internal document (later marked in evidence as Trial Ex. 4026 and discussed *supra*) stating that [REDACTED] (emphasis added). Additionally, it is noteworthy that Professor Shapiro did not specifically address the point in Harrison WDT ¶ 41 where Mr. Harrison identified [REDACTED] because he

Indeed, were it not for [REDACTED], its position [REDACTED] would make it [REDACTED], because [REDACTED]. That is, the Majors, as complementary oligopolists, would prefer to keep downstream competition roiling to avoid a downstream extraction of monopoly profits (double marginalization) that would reduce the Majors' revenues, as discussed in *Web IV* and noted earlier in this Determination.

The Judges note that, ultimately, in their post-hearing briefing, the Services do appear to acknowledge that the Majors [REDACTED] Services RPFCL ¶ 477 (emphasis added). The Services assert, though, that this reflects only that Spotify has “[REDACTED], which, they contend, would explain why the Majors [REDACTED]. Services RPFCL ¶ 477 (emphasis added). But, the Judges find this assertion to be fully consistent with their finding that Spotify's much different circumstances explain why it had countervailing power—generated by the confluence of 1) [REDACTED] and 2) its own status as the [REDACTED].⁷⁷

Finally, according to the Services, the Majors' [REDACTED] “does not inform the demonstrated reasons why they [REDACTED] Services RPFCL ¶ 477. The Judges partially agree: the Majors' decision [REDACTED] is not informative—*standing alone*—to explain why they did [REDACTED]. However, the Services are simply in error when they say the Majors' [REDACTED] was disconnected from [REDACTED].

identified the Harrison WDT as a document upon which he relied in preparing his rebuttal testimony. Shapiro WRT app. A.

⁷⁷ As the Judges have explained in other circumstances, licensors will also charge different licensees different royalties to promote price discrimination and in recognition of a licensee's lower willingness-to-pay (often as a function of its lower ability-to-pay). But, a licensor will not offer a licensee a lower rate if that licensee's presence serves to cannibalize the business of services paying higher royalties (as Professor Willig explains well in this proceeding). Here, after the [REDACTED] [REDACTED]. Thus, providing [REDACTED]. There was; and that particular attribute—as the record demonstrates—was [REDACTED].

As the record discussed above reveals, the connection is clear: SoundExchange provided ample evidence that the Majors [REDACTED]. And, to reiterate, Spotify came to possess that power because it had developed a market-leading business while [REDACTED].⁷⁸

**e. There is Agreement that Spotify’s Subscription Royalty Rate is
[REDACTED] Set through the Exercise of Complementary Oligopoly
Power Alone**

Notwithstanding the foregoing analytical disputes, Professor Shapiro acknowledges that Spotify’s subscription royalty rate equates with a rate he identifies as set without the anticompetitive effect of complementary oligopoly power. As SoundExchange explains—relying on Professor Shapiro’s own testimony—in the course of developing his proposed competition adjustment, he calculates [REDACTED]’s effective per-play interactive royalty rate at \$[REDACTED]. Ex. 4094 at 40 & tbl.10

⁷⁸ Additionally, the Judges reject the Services’ argument as reductive. That is, the Services treat the complementary oligopoly *structure* of the licensor side of the market as wholly explanatory of the [REDACTED]. In other words, they essentially assert that because the licensors are complementary oligopolists *any* [REDACTED] must be a matter of pure self-interest. But, that structural explanation ignores the dynamic and strategic *competitive effects* revealed by the present record: [REDACTED]; [REDACTED]; and the interplay of those two forces that provides Spotify with a countervailing power [REDACTED]. The Services’ argument also is inconsistent with the fundamental economic concept of “Pareto Optimality,” which posits that any consensual transaction between private actors is efficient, in the sense that it benefits each party (or else it would not enter into the transaction). To be sure, if a party is not a willing buyer or seller, whether because of a counterparty’s excessive market power or otherwise, this optimality is not realized, but here the Majors and Spotify found it in their interest, through the exercise of their countervailing power, to enter into agreements containing [REDACTED]. Accordingly, it is incorrect to state, as the Services do, that the negotiated [REDACTED] cannot be in the *mutual* interest of Spotify and the Majors.

(SCWDT of Carl Shapiro) (Shapiro WDT). Then, he characterizes this \$[REDACTED] rate as an effectively competitive rate (as a base for comparison with other rates he identifies as not effectively competitive). *Id.* at 40; 8/19/20 Tr. 2850 (Shapiro).⁷⁹

SoundExchange notes that, according to Professor Shapiro's own calculations, *Spotify's* effective subscription per-play rate is \$[REDACTED], Shapiro WDT at 40, tbl.10, *[REDACTED] to the [REDACTED] rate he characterizes as free of the complementary oligopoly effect.* 8/20/20 Tr. 3112-13 (Shapiro); *see also* 8/10/20 Tr. 1170 (Orszag). SoundExchange further notes that Professor Shapiro acknowledges, as he must, that these two rates are [REDACTED] 8/20/20 Tr. 3113 (Shapiro). Given this [REDACTED], Mr. Orszag opines that, at most, a competition adjustment should measure the difference between the Spotify effective rate (\$[REDACTED]) and the [REDACTED] effective rate (\$[REDACTED]). Orszag WDT ¶ 114. This difference would lead to a [REDACTED]% effective competition adjustment.⁸⁰

After first conceding [REDACTED] the Services attempt to dismiss the importance of this equivalency – in a reply, quoted below – that is off-point and unconvincing:

In an attempted “gotcha,” Mr. Orszag argues that if [REDACTED]'s per-play rate of \$[REDACTED] reflects the lack of must-have power, and if [REDACTED] pay \$[REDACTED] per performances (*see* Shapiro WRT at 30 fig. 3), then the record companies must not be must-have for those services either—in which case there is no need to adjust the Spotify rates any further for effective competition (or to make an adjustment of only

⁷⁹ Professor Shapiro reaches this opinion based on the limited repertoire available on [REDACTED], which he understands to demonstrate that customers “do not expect to find all their favorite artists and recordings on the service.” Shapiro WDT at 40. Thus, he opines that, for [REDACTED], no record company is a Must Have, making the rate effectively competitive. 8/20/20 Tr. 3110-11, 3117-19 (Shapiro).

⁸⁰ $[REDACTED]/[REDACTED] = [REDACTED]$

$[REDACTED] - [REDACTED] = [REDACTED]\%$.

[REDACTED]⁸¹ ([REDACTED])). Orszag WRT ¶ 114. ... Mr. Orszag is resorting to sleight-of-hand. Because he artificially excludes all the discounted plans from his calculations, the effective per-play rate of Spotify plans on which he actually relies for his benchmark is \$[REDACTED], not \$[REDACTED]. Moreover, as explained at length above, he does not use the per-play rate at all, but rather alters the *Web IV* methodology by starting from Spotify's percent-of-revenue royalty. ...

Were Mr. Orszag actually working from a \$[REDACTED] per performance benchmark and following the *Web IV* methodology [by] ... drop[ping] his industry-wide interactive per-play benchmark ... he might have a point—but he does not.

Services PFFCL ¶ 160.

This criticism is off-the-mark because it explains why the Services believe that *Mr. Orszag* improperly ignored Spotify's \$[REDACTED] effective per-play subscription rate. But the point here is not what Mr. Orszag did or did not do with this data point, but rather that Professor Shapiro identified two [REDACTED] royalty rates as simultaneously satisfying and not satisfying the effective competition requirement (inconsistent with the principle of transitivity). The Services' response fails to address that point.

The Judges find that the [REDACTED] is generally confirmatory of the fact that Spotify's [REDACTED] is not—as the Services maintain—a product solely of the Majors' complementary oligopoly power.⁸²

⁸¹ This [REDACTED]% calculation appears to be a computational error, as indicated by the math in the immediately preceding footnote.

⁸² However, the Judges do not find that the [REDACTED] of Spotify's effective per play rate with [REDACTED]'s per play rate limits the effective competition adjustment to the [REDACTED] in those rates. Rather, as discussed elsewhere in this Determination, the Judges agree with Dr. Peterson (Google's expert economic witness) that the 12% steering adjustment from *Web IV* remains applicable here. But, as also described elsewhere herein, that 12% downward adjustment must be offset by use of the [REDACTED]), as applied to the segments of the Spotify market for which the [REDACTED] applied. *See* Peterson WDT fig. 5 ([REDACTED]). Further, by limiting the application of the [REDACTED]"

**f. The Majors' [REDACTED] Explains the [REDACTED] of the
Ongoing Negotiations**

The Majors' [REDACTED] explains the flow of the ongoing negotiations between the Majors and Spotify. Unlike a negotiation in which the complementary oligopolists' "Must Have" status allows them to dictate terms, they [REDACTED].

In this regard the Services describe these negotiations as follows:

[W]hat is apparent from the evidentiary record is [REDACTED] ... *par for the course in a deal negotiation*

Services RPFCL ¶¶ 426-427 (and record citations therein).

But, the point of complementary oligopoly power is that a "Must Have" supplier/licensor [REDACTED] to its buyers/licensees. And yet, here the Services acknowledge that the Spotify-Major negotiations were marked by a [REDACTED], as happens in *any* negotiation. Clearly, given that the Majors remained "Must Have" licensors, something else [REDACTED], and, as discussed above, that "something else" is Spotify's countervailing power flowing from its status as the [REDACTED].⁸³

The [REDACTED] is clear in the record. Among the provisions that the Majors prevailed on (and, thus reciprocally, as to which [REDACTED] were four important

adjustment only to Spotify market segments to which that rate actually applied, the Judges have allayed a final argument by the Services, *viz.*, that the evidentiary value of the Spotify and [REDACTED] should not apply beyond the subscription tier. *See* Services PFFCL ¶ 161.

⁸³ The Services maintain that, as a general rule, complementary oligopolists, like monopolists, negotiate with their counterparties, but that does not demonstrate the existence of effective competition. Shapiro WRT at 1; *see also Web IV*, 81 FR at 26344 (monopolists and complementary oligopolists bargain with their customers to establish discriminatory prices that increase the sellers' profits). That is certainly true, but it is insufficient for the Services simply to maintain, *ipse dixit*, that *any* "give-up" by a Major in negotiations represents the foregoing elements of negotiation rather than a "give-up" generated by identifiable countervailing power.

items: 1) [REDACTED], 2) [REDACTED], 3) [REDACTED], and 4) [REDACTED].

Services PFFCL ¶¶ 146, 157-158 (and record citations therein).

And, on the other side of the ledger, among the provisions as to which [REDACTED] in negotiations (and, thus reciprocally, as to which [REDACTED]) were the following important items: 1) [REDACTED], 2) [REDACTED], 3) [REDACTED] [REDACTED], and 4) [REDACTED] [REDACTED]. SX PFFCL ¶¶ 293, 413, 431-432, 444; SoundExchange's Corrected Replies to the Services' Joint Proposed Findings of Fact and Conclusions of Law ¶ 158 (and record citations therein) (SX RPFCL (to Services)). This [REDACTED] led the Services to describe that process as typical of an ordinary bargaining process when each counterparty has bargaining leverage. *See* Services RPFCL ¶¶ 413; 424, 426-427 (and record citations therein) (it is “*unsurprising*” that “*each party* to the negotiation [REDACTED]; it is “*inevitable* [that] *not all* [REDACTED] will form part of the ... agreement”; and “what the [Warner-Spotify negotiation] record shows is [REDACTED] (emphasis added). These descriptions are not consistent with the one-sided negotiations between complementary oligopolists and their relatively powerless counterparties, belying the Services’ assertion that these negotiations reflected the one-sided power of the Majors’ complementary oligopoly status.⁸⁴

Finally, consistent with the idea that the Majors would continue to bargain ([REDACTED])—is the following succinct colloquy (referred to *supra*) between Spotify and Warner negotiators in October 2016, as recounted in one of Warner’s internal documents:

⁸⁴ By contrast, SoundExchange, in its zeal to portray Spotify as [REDACTED] in these negotiations, studiously ignores the fact that Spotify [REDACTED]. The Judges see this as “hyperbole-by-omission.” The Judges reject any notion that Spotify had acquired unilateral power to dictate terms; rather, its [REDACTED] provided it with a power to countervail the Majors’ Must Have power.

[REDACTED]

[REDACTED]

Trial Ex. 4022 (emphasis added). As noted *supra*, Warner was making a basic economic point: It understood that Spotify, as a [REDACTED]. The [REDACTED] realized by the Majors reflect [REDACTED] to incur for this benefit, and the Majors' [REDACTED] reflect [REDACTED] to incur.

In sum, the Judges find that the negotiation documents on which SoundExchange relies reflect bargaining that is consistent with: 1) the testimony of the Majors' witnesses regarding [REDACTED] and 2) the economic principle of countervailing power that, as discussed *supra*, could and did blunt some of the Majors' complementary oligopoly power, [REDACTED] toward an effectively competitive rate, even in the absence of horizontal price competition.⁸⁵

C. The Price Competition Adjustment Necessary to set an Effectively Competitive Rate

In the exercise of their statutory duty to “to decide whether the rates proposed adequately provide for an effective level of competition,” *SoundExchange, Inc. v. Copyright Royalty Bd.*, 401 F.2d 41, 57 (D.C. Cir. 2018), the Judges find that the 12% effective competition adjustment that they set in *Web IV* remains an appropriate measure for an effective competition adjustment (before any necessary adjustment to reflect Spotify's countervailing power). To recap, the 12% effective competition adjustment was based on a factual record that included Pandora Steering Experiments, a steering-

⁸⁵ The Majors' [REDACTED]. As noted *supra*, in an internal Sony email from a Sony line negotiator, Andre Stapleton, to Mr. Piibe, Trial Ex. 5467, discussed *supra*, the [REDACTED]. By contrast, Mr. Sherwood, a Warner witness, [REDACTED], testifying, as noted *supra*, that [REDACTED]. 9/9/20 Tr. 5931 (Sherwood).

based agreement between Pandora and Merlin,⁸⁶ and a steering-based agreement between iHeart and Warner. The *Web IV* Judges defined steering in the same manner as defined by the parties in this proceeding, *i.e.*, as a licensee’s “ability to control the mix of music that’s played on the service in response to differences in royalty rates charged by different record companies.” *Web IV*, 81 FR at 26356.

The Judges in *Web IV* construed the economics of steering in the following manner:

[S]teering in the hypothetical noninteractive market would serve to mitigate the effect of complementary oligopoly on the prices paid by the noninteractive services and therefore move the market toward effective, or workable, competition. *Steering is synonymous with price competition in this market, and the nature of price competition is to cause prices to be lower than in the absence of competition, through the ever-present “threat” that competing sellers will undercut each other in order to sell more goods or services.*

Web IV, 81 FR at 26366 (emphasis added). Moreover, the *Web IV* Judges noted that the steering evidence was especially probative because it consisted of “a *combination* of benchmarks, experiments and expert economic theorizing using fundamental principles of profit maximization and opportunity cost ... [a] combination of proofs and arguments [that] is actually *more persuasive* to the Judges than a mere benchmark standing alone.” *Web IV*, 81 FR at 26367 n.141. Relying on all the steering evidence presented, the *Web IV* Judges determined that benchmark rates that were inflated by the complementary oligopoly effect needed to be adjusted downward by 12%, in order to establish an effectively competitive rate. *Web IV*, 81 FR at 26404-05.

Additionally, crucial evidence that supported the Judges’ *Web IV* finding of a 12% adjustment is part of the *present* record, having been designated as such by Pandora. Specifically, Pandora designated as part of the *Web V* record the *Web IV* Written Direct

⁸⁶ Merlin is referred to in the music industry as “the fourth major.” *See, e.g.*,

<https://theindustryobserver.thebrag.com/heres-to-ten-years-of-merlin/> (accessed June 7, 2021).

Testimony and hearing testimony of Stephan McBride, Pandora’ Senior Scientist responsible for the Pandora Steering Experiments on which the Judges relied. *See* Trial Exs. 4104 & 4105; *see generally* 37 CFR 351.4(b)(2) (permitting a party to designate “past records and testimony” for inclusion in its Written Direct Statement).

The Judges in *Web IV* described the Pandora Steering Experiments as follows:

Pandora’s ... steering experiments ... consist of comparisons between randomly selected groups of listeners, one group receiving a manipulated experience (the “treated” group) and the other group receiving the standard Pandora experience (the “control” group). ... These experiments are randomized, controlled, and blind

Pandora initiated the steering experiments because ... it recognized that, as a noninteractive service it has the economic incentive to “steer” its performances toward music owned by a particular record company if that music is available at a lower royalty rate. ... Therefore, Pandora decided to determine through its steering experiments whether and to what extent it could use this technological ability to steer performances *without negatively affecting listenership*.

...

The Steering Experiments consisted of a group of 12 experiments. Each experiment involved a combination of one of three target ownership groups (UMG, Sony or WMG) and a target “deflection” in share of spins (treatment group) as compared to spins that would occur according to the standard Pandora music recommendation results (control group)

The experiments demonstrated that Pandora was able to steer +15% or -15% for all three Majors without causing a statistically significant change in listening behavior. McBride WDT ¶ 21. However, Pandora was unable to steer +30% or - 30% for Universal or Sony without creating a statistically significant change in listening behavior.

Web IV, 81 FR at 26357-58 (emphasis added).

As noted above, the Judges also relied on provisions in two agreements. First, *Web IV* noted that “the central piece” of the agreement between Pandora and Merlin was a “reduced per-play rate in exchange for increased plays”—the very essence of steering. *Web IV*, 81 FR at 26357. The second agreement the Judges relied on in *Web IV* was the iHeart/Warner agreement which the *Web IV* Judges described as “incorporat[ing] the same economic steering logic as the Pandora/Merlin Agreement [by] [c]reat[ing] an

incentive for iHeart to increase Warner's share of performances substantially." *Web IV*, 81 FR at 26375. As with the Pandora/Merlin Agreement, the *Web IV* Judges described this "steering aspect" of the contract as reflective of "price competition — an increase in quantity (more performances) in exchange for a lower price (a lower rate)." *Web IV*, 81 FR at 26383.

SoundExchange argues that this evidence of steering is now "stale," because the experiments are outdated, as are the two cited agreements, SX PFFCL ¶¶ 490-91.⁸⁷ But the dates of the experiment and those agreements are insufficient to wash away the importance of steering as a price competition mechanism applicable to the noninteractive market. The Judges note that SoundExchange could have called a witness from Merlin in *Web V* (as it did in *Web IV*) to present testimony that may have shed light on *why* its [REDACTED] but elected not to.⁸⁸ By contrast, Pandora presented testimony from Professor Shapiro explaining that Merlin (and the Majors) had refused to agree to continue steering. Specifically, Professor Shapiro testified:

Following the *Web IV* Determination, as a condition for obtaining the additional rights necessary to offer its non-statutory services, [REDACTED]. These provisions appear to be the result of the complementary oligopoly power held by certain record companies in the market for licensing recorded music to interactive services. *Given these provisions, Pandora has been unable to offer to steer toward other labels in exchange for a discounted royalty rate from them, lest it jeopardize the share of other labels in violation of their anti-steering provisions. As a result, competition for incremental performances on Pandora in the form of steering has been snuffed out.*

Shapiro WDT at 9-10 (emphasis added); *see also* Trial Ex. 4090 ¶ 24 (WDT of Christopher Phillips) (Phillips WDT) (noting the existence of the [REDACTED]).

⁸⁷ The Pandora/Merlin agreement was executed on June 16, 2014, the iHeart/Warner agreement was entered into on October 1, 2013, and the Pandora Steering Experiments were conducted between June 4 and September 3, 2014. *Web IV*, 81 FR at 26355, 26357, 26375.

⁸⁸ The [REDACTED]. *See* SX PFFCL ¶ 1168 (and record citations therein).

In response, SoundExchange asserted that: (1) Pandora had not offered any further evidence or testimony beyond the testimony cited above; (2) it was not clear that [REDACTED]; (3) Pandora had “considerable leverage in negotiations” because it could default to the statutory rate. SoundExchange's Corrected Replies to Pandora and Sirius XM's Corrected Proposed Findings of Fact and Conclusions of Law ¶ 21 (SX RPFCL (to Pandora/Sirius XM)).

The Judges find SoundExchange's arguments unavailing. As already noted, SoundExchange could have attempted to rebut Pandora's testimony by calling a Merlin representative, as it had in *Web IV*, yet it declined to do so. When a party is in a position to proffer testimony or evidence that would elucidate a point, or rebut an adverse point, but declines to do so, a finder of fact may determine that the testimony would not have been supportive of that party's position. *See Huthnance v. District of Columbia*, 722 F.3d 371, (D.C. Cir. 2013) (Under the “missing evidence rule, when a party has relevant evidence [which includes testimonial evidence] within his control which he fails to produce, that failure gives rise to an inference that the evidence is unfavorable to him”). The Judges infer that the absence of a Merlin witness indicates that the testimony of a Merlin witness would not have been favorable to SoundExchange's argument on this steering issue. Moreover, there is simply *no* evidence to contradict the testimony of Professor Shapiro in this regard.

In the present case, the absence of a Merlin witness is particularly noteworthy. As Dr. Peterson recounted in his testimony, SoundExchange had in the recent past—*after Web IV*—cautioned Indies that entering into direct agreements with services, even though they appear advantageous to the Indies, may ultimately be used in rate proceeding as evidence to support a *lowering* of statutory royalty rates. 8/25/20 Tr. 3673 (Peterson); Trial Ex. 2113 (SoundExchange's 2015 notice informing labels they “should ... keep in mind that any direct deals might be used against artists and record companies as

evidence,” and that because “[d]igital radio services are intensely focused on how market evidence will be used in their case, ... you should be as well.”). Although there is no evidence that SoundExchange repeated that cautionary communication in the run-up to *Web V*, there is also no evidence that it has ever retracted this warning. Thus, in this context, the absence of a Merlin witness to explain the [REDACTED] is of even greater importance.

Further, SoundExchange’s assertion that steering beneficial to Pandora may have remained possible under its agreement with Merlin – and yet Pandora nonetheless acted against its self-interest and [REDACTED] – is simply bewildering; the Judges do not assume that sophisticated commercial entities engage in economically irrational conduct. Also, SoundExchange’s assertion that Pandora enjoyed “considerable leverage in the negotiations” with Merlin is purely speculative (given the absence of record evidence demonstrating such leverage) and also runs counter to an essential premise of SoundExchange’s case-in-chief, presented through Professor Willig, that as a matter of bargaining strategy and modeling, the record companies would not engage in steering because it would thwart the maximization of their “Must Have” value. *See* 8/10/20 Tr. 1077-78 (Willig).

Additionally, [REDACTED] was one of the very devices SoundExchange claimed in *Web IV* that record companies would use to defeat steering-based price competition. *Web IV*, 81 FR at 26364. In response, the Judges found such a contract term would constitute an exertion of the licensors’ complementary oligopoly power, frustrating the setting of an effectively competitive rate. *Web IV*, 81 FR at 26373-74 (“the hypothetical use by the majors of anti-steering clauses in response to the threat of price competition-via-steering would thwart ‘effective competition.’”). Here too, it would be anomalous (in the nature of a *Catch-22*) for the Judges to disregard the capacity

of price-competitive steering to offset a complementary oligopoly effect because a record company had used such power to thwart the continuation of such steering.

Further, the Judges' task is to set a rate that equates with an effectively competitive rate that would have been agreed to by willing buyers and sellers in a *hypothetical* market. The Pandora/Merlin and iHeart/Warner agreements demonstrate that *actual* steering has occurred in the market. *A fortiori*, steering is clearly an element of the hypothetical market (as shown by the Pandora Steering Experiments) that the Judges must construct.

The Judges also note that in the present case, Dr. Leonard, the economic expert for the NAB, adopts the 12% steering adjustment applied by the Judges in *Web IV* in order to establish an effectively competitive rate. Trial Ex. 2150 ¶ 115 (CWDT of Gregory Leonard) (Leonard WDT). In his oral testimony, Dr. Leonard testified that any initial reluctance he may have had to “reuse” this 12% adjustment was outweighed by the fact that this adjustment: (1) is based contractual agreements; (2) is the product of agreements entered into “not that long ago”; and (3) is “conservative” and “small” relative to the complementary oligopoly effect in the present circumstances. 8/24/10 Tr. 3410 (Leonard).

In addition, Google's economic expert, Dr. Peterson, testified in favor of utilizing this same economic evidence to support the steering adjustment in the present case. Dr. Peterson's testimony in this regard is well worth quoting:

In a *hypothetical* effectively competitive market, statutory streaming services, such as custom radio services, have the potential to steer the music they use toward or away from particular labels [because] [m]usical recordings are differentiated but substitutable products.... [T]he service can reduce the number or share of plays for a given label's recordings if the license rate is too high. This response to rate differences is called steering.... [I]t is appropriate that the *hypothetical negotiation* between statutory streaming services and licensors reflect some degree of competition from steering or the ability of the streaming services to substitute one label's recordings for another's relative to the rates that the labels charge acting as Cournot oligopolists.

The evidence available to me in this proceeding does not include recent licenses with steering adjustments built into them as was the case in the *Web IV* proceeding. However, *I am aware of no evidence that a stand-alone statutory webcaster would not be able to steer toward or away from labels, which would lead to their competing at the margin for additional plays on the service.*

In the absence of new benchmarks, it can be appropriate to use previous benchmarks. In the Web IV proceedings, there was ample evidence of the ability of statutory streaming services to steer toward or away from record labels. Thus, the evidence indicates that listener behavior permits statutory webcasters to engage in substantial steering without negatively affecting their user base. In the hypothetical effectively competitive marketplace for licensing statutory webcasters, licensors would not be in the position of Cournot oligopolists because their high license fees would affect the spins of their works directly.

Trial Ex. 1103 ¶¶ 37, 58-61, 64 (emphasis added) (CWDT of Steven Peterson) (Peterson WDT). Relying on this analysis, and also considering other evidence, Dr. Peterson opined that a reasonable range for the steering-based effective competition adjustment was between 11% and 23% (which includes the Judges' 12% adjustment). Peterson WDT ¶ 65.

The Judges agree with Dr. Peterson. They emphasize that *basic economic principles* do not change with the mere passage of a few years. Although new probative factual evidence or advances in economic theory or modeling presented by an expert witness *could* show either that the principle is factually inapplicable or needs to be revisited, no such record has been presented in this proceeding. Accordingly, the Judges find that the economic experts cited above⁸⁹ have properly relied on the evidence

⁸⁹ Pandora's economic expert, Professor Shapiro, although presenting in this proceeding a "carriage competition" model relying on the Label Suppression Experiments, rather than a steering-based adjustment, nonetheless has acknowledged previously that "a streaming service that possesses an ability to "steer" towards certain recordings, and away from others, will have 'much more bargaining power and be able to negotiate a lower royalty rate,' reflecting "price competition at work," and the workings of an "effectively competitive market." *Web IV*, 81 FR at 26356-57. Thus, experts for all the commercial services are on record as supporting the use of a steering adjustment to generate an effectively competitive rate.

supporting the *Web IV* steering adjustment to establish the appropriate steering adjustment in this proceeding.⁹⁰

A final aspect of the *Web IV* and *Web V* proceedings adds to the ample evidence supporting the use of a steering adjustment to establish an effectively competitive rate. In this *Web V* proceeding, Professor Willig, a SoundExchange economic witness, while testifying in support of his Shapley Value Model, emphasized repeatedly that Majors were “Must Haves” in the noninteractive market because their repertoires included the bulk of sound recording “hits” that listeners wanted to hear. *See, e.g.*, 8/5/20 Tr. 400 (Willig) (“Must Have” status is “really about the hits”); 8/5/20 Tr. 440 (Willig) (the hits are “terribly important” to the overall value of listening); 8/5/20 Tr. 448 (Willig) (the Majors’ collection of hits is what makes them “Must Haves”); 8/6/20 Tr. 807 (Willig) (the level of spin rates on noninteractive services is a function of the plays of current hits); Trial Ex. 5601 ¶ 28 & n.46 (WRT of Robert Willig) (Willig WRT) (Universal has a [REDACTED]% share of the streams but accounts for [REDACTED]% of the top 100 hits according to 2019 *Billboard* data relied on by Professor Willig).

Similarly, in *Web IV*, the Judges took note of the importance of hits (“top spins”) to a noninteractive service. *Web IV*, 81 FR at 26373 n.155 (“‘top spin’ figures are indicative of the ‘must have’ aspect of the Majors’ repertoire ... suggest[ing] to the Judges that the popularity of the Majors’ spins is the reason why steering away from their repertoires cannot be pursued beyond a certain level, and why [Professor] Shapiro candidly declined to reject the idea that the Majors’ repertoires were ‘must haves’”).

⁹⁰ The Judges have also not hesitated to apply evidence from a prior proceeding when they have found the prior evidence to be superior to the evidence presented in the new proceeding. *SDARS II*, 78 Fed. Reg. at 23063 (“The Judges rely [*inter alia*] ... on ... the unadjusted upper bound in *SDARS-I* to guide the determination of what the upper bound should be in this proceeding.”).

Professor Willig's emphasis in this proceeding on the Majors' possession of many of the "hits" puts a fine point on the steering issue. The noninteractive services need to play the "hits" (at intervals consistent with the sound recording performance complement) in order to remain attractive to their listeners and subscribers. That necessity renders the Majors "Must Have" licensors. However, the flip-side of this appropriate emphasis on the "hits" is a de-emphasis on less popular sound recordings, *and therein lies the ability of the noninteractive services to engage in price competition by embedding steering into their algorithmic or human curation system.*

That is, noninteractive services can (and, in the case of [REDACTED], *did*) steer curated songs that were not necessarily the hits/top spins, in a manner that [REDACTED]. *See Web IV*, 81 FR at 26368-69 (explaining why substituting a curated song with a [REDACTED] did not impact listeners but improved the bottom lines of the services and labels that engaged in steering). When the Judges consider this point together with Professor Willig's testimony regarding the need of noninteractive services to obtain licenses necessary to play all the hits, the economic coexistence *of the noninteractives' steering ability and the Majors' "Must Have" status remains clear.*

Finally, the Judges note that none of SoundExchange's arguments indicates that the fundamental economics of noninteractive services have changed in any manner that would make steering by such services a less useful tool for applying an appropriate steering adjustment. Rather, as Dr. Peterson testified, "the ability to steer for a non-interactive statutory service is pretty much bred right into the nature of the service where it's choosing the songs." 8/25/20 Tr. 3668 (Peterson).

In sum, the Judges find it appropriate—for the reasons discussed above—to apply a 12% steering adjustment (prior to the offsets discussed below) in order to generate a competitive rate.

D. The Countervailing Power Offset to the Price Competition Adjustment

As discussed more fully elsewhere in this Determination, the Judges find that Spotify, through its success as a market leader among interactive services and as the dominant independent pureplay interactive service, has acquired a significant measure of bargaining power in its licensing negotiations with the Majors. To summarize very briefly, the evidence demonstrates that Spotify's [REDACTED]—in the interactive market. *See supra*, section III.B.2.

Spotify's bargaining power allowed it to bargain for [REDACTED].⁹¹ This reduction is a function of the countervailing power discussed *supra*, which can serve as a means for reducing prices (and rates) *toward* a level indicated by the processes of price competition that are the hallmark of traditional neoclassical microeconomics.

In this regard, it is noteworthy that one of SoundExchange's economic expert witnesses, Mr. Orszag, acknowledges that the 12% effective competition adjustment can be applied, if [REDACTED]. 8/25/20 3837 (Orszag) ("[REDACTED]").⁹²

Here, [REDACTED]. A 12% price competition adjustment is warranted. But [REDACTED]. Thus, an appropriate adjustment for rates using this benchmark is 12% - [REDACTED], or [REDACTED]%.

However, as explained *infra*, that [REDACTED]% adjustment applies only to a headline rate that serves as a benchmark in this proceeding and that is consistent with [REDACTED] in the *effective* per-play rate. To the extent the [REDACTED]% adjustment does not apply to discounted subscriptions, such as student plan subscriptions,

⁹¹ [REDACTED]% - [REDACTED]% = [REDACTED]%. [REDACTED]%/[REDACTED]% = [REDACTED]%.

⁹² The Judges do not agree with Mr. Orszag's levels of adjustment to reduce the 12% factor, but his concept is the one the Judges are applying in this proceeding.

or to ad-supported plans, then the [REDACTED]% reduction is not applicable. Rather, in such instances, the full 12% competition adjustment applies.⁹³

IV. Commercial Webcasting Rates

A. Evaluation of Survey Evidence

1. Zauberman Music-Listening Behavior Survey

a. Description of the Zauberman Survey

Professor Willig's opportunity cost approach is dependent upon the results of the consumer behavior surveys.⁹⁴ The Judges, therefore, test the underlying survey data on

⁹³ The Judges recognize, as they did in *Web IV*, that estimating a rate that reflects effective competition is not an exact science. See *Web IV*, 81 Fed. Reg. at 26334 (“The very essence of a competitive standard is that it suggests a continuum and differences in degree rather than in kind.”). However, the *quality* of the steering evidence in *Web IV* allowed the Judges to identify with some precision the “range of potential steering adjustments, notwithstanding the otherwise inherently ‘fuzzy’ nature of the ‘bright line’ ... between effectively competitive and noncompetitive rates.” *Web IV*, 81 Fed. Reg. at 26344. Here, applying that steering evidence together with the offset indicated by the *Web V* record represents another application of specific evidence to put into focus the necessary size of the effective competition adjustment. Mr. Orszag likewise acknowledges that identifying the impact of market developments on the ascertainment of an effective competition adjustment cannot be determined with absolute precision. 8/11/20 Tr.1276 (Orszag) (“[T]hese are areas of gray. ... [M]arkets can be less workably competitive or less effectively competitive and more effectively competitive.”). And, to compare markets over time to identify the change to the level of an effective competition adjustment, Mr. Orszag opines that “[f]rom an economic perspective, what one can do is utilize calibration or empirical evidence to understand how markets have changed. 8/12/20 Tr. 1653 (Orszag). The Judges quite agree, and that is what they have undertaken in this Determination—to use the empirical data and related evidence to calibrate the extent to which an effective competition adjustment is required in the noninteractive subscription and ad-supported markets.

⁹⁴ One input in calculating a record company's opportunity cost of licensing its repertoire to a statutory webcaster is a diversion ratio, which measures how listening is spread across a range of alternative listening

which he relied to assess their reliability or their strength in supporting Professor Willig's conclusions.

SoundExchange engaged Professor Gal Zauberman to measure the music-listening behavior of listeners to streaming radio services.⁹⁵ Trial Ex. 5606 ¶¶ 1, 4 (WDT of Gal Zauberman) (Zauberman WDT). Professor Zauberman conducted an Internet-based survey with the assistance of the Brattle Group, an economic consulting firm, and Dynata, a marketing research company with extensive experience in conducting surveys. Zauberman WDT ¶ 28. Specifically, the survey explored how consumers of streaming radio services that are eligible for the webcasting statutory license would listen to music if those streaming radio services were not available. Zauberman WDT ¶ 12. The survey respondents were asked about their listening behavior in a hypothetical world in which either free or paid streaming radio services were no longer available. Zauberman WDT ¶ 13.

The Zauberman Survey consisted of three key types of questions: respondents were asked about which music-listening options they have used in the past 30 days, either a free or paid streaming radio service (Q1), which replacement music-listening options they would choose instead of the free or paid streaming radio service set forth in their assigned hypothetical scenario (Q2), and (in some cases) how they would allocate their

sources in the event that listeners stop listening to a statutory webcaster because a label's repertoire is no longer available.

The Judges discuss Professor Willig's economic modeling *infra*, section IV.C.1.

⁹⁵ Professor Gal Zauberman, is the Joseph F. Cullman 3rd Professor of Marketing at the Yale School of Management, who specializes in consumer judgment and decision-making, financial decision-making, and survey methodology. Zauberman WDT ¶¶ 1, 4.

replacement time music-listening options (Q3, 3A) among replacement options.

Zauberman WDT ¶ 51.⁹⁶

Among the 6,146 respondents who were asked which type of music-listening options they had used in the prior 30 days (Q1), 66 percent (4,029 respondents) responded that they had used a free streaming radio service in the past 30 days, and 21 percent (1,278 respondents) responded that they had used a paid streaming radio service in the past 30 days. Altogether, 71 percent (4,369 respondents) said they had used either free or paid streaming radio (or both), and 15 percent (938 respondents) said they had used both free and paid streaming radio services in the past 30 days. Zauberman WDT ¶ 68.

Out of the 1,552 respondents who were not excluded and completed the survey, a total of 989 respondents were assigned to the scenario in which free streaming radio services are no longer available (Q2). The survey assigned 563 respondents to the scenario in which paid streaming radio services are no longer available. Zauberman WDT ¶ 56. After being provided with the respective scenario in which free or paid streaming radio services were no longer available, respondents were asked a series of questions about how they would replace the time they currently spent listening to music on their free or paid streaming radio services. Respondents were then presented a variety of music-listening options with the exception of the streaming radio option that was no longer available in their given scenario. Zauberman WDT ¶ 57.

⁹⁶ A total of 21,335 respondents entered the survey: 6,146 respondents answered Q1 and 2,151 respondents answered Q2. Of these, 1,552 qualified respondents completed the survey without being excluded for selecting “Unsure” for any of the options in Q1 or Q2. These 1,552 respondents did not include 88 respondents who were excluded for completing the survey in what was judged to be too little time or too much time. Zauberman WDT ¶ 53.

Out of 989 respondents who completed the survey and were told that *free* streaming radio services were no longer available, the (Q2) responses indicated that 33 percent of current listeners of free streaming radio services would instead listen to paid streaming radio services, 80 percent would instead listen to free On-Demand streaming services, 39 percent would instead listen to paid On-Demand streaming services, 31 percent would instead listen to Sirius XM satellite radio services on a satellite receiver, 85 percent would instead listen to AM/FM radio on a traditional radio receiver, 69 percent would instead listen to CDs, vinyl records, or MP3 files they currently own or would purchase, and 48 percent would instead do something other than listen to music.⁹⁷ Zauberman WDT ¶ 24, 72, fig. 8.

Out of 563 respondents who completed the survey and were told that paid streaming radio services were no longer available, the (Q2) responses indicated that 84 percent of current listeners of paid streaming radio services would instead listen to free streaming radio services, 83 percent would instead listen to free On-Demand streaming services, 71 percent would instead listen to paid On-Demand streaming services, 52 percent would instead listen to Sirius XM satellite radio services on a satellite receiver, 79 percent would instead listen to AM/FM radio on a traditional radio receiver, 67 percent would instead listen to CDs, vinyl records, or MP3 files they currently own or would purchase, and 50 percent would instead do something other than listen to music. Zauberman WDT ¶ 25, 74, fig. 9.

The respondents who answered the (Q2), saying that they would replace their streaming radio service that is no longer available with either (a) a free On-Demand service or (b) a free streaming radio service (if their paid streaming radio service were no

⁹⁷ The percentages add up to more than 100% because respondents were permitted to select multiple replacement options. See Zauberman WDT app. D.

longer available), and who chose at least one other music-listening option (or “[d]o something other than listen to music”) as a replacement for their streaming radio service that is no longer available, were asked (in Q3) if they would expect to listen to their streaming radio service one week from the day on which the respondent was taking the survey, if it were available.⁹⁸ Zauberman WDT ¶ 75.

This form of questioning was designed to account for the possibility that time spent listening to music may vary from day to day for different people and across the respondents’ allowed measurement of listening time across all days of the week. The day of week question format was also designed to be as specific as possible about the occasion that they are estimating and to have the estimation day not too far into the future. Zauberman WDT ¶ 61-62.

The respondents who answered “Yes” to Q3 were then asked to allocate their time among replacement options they chose in the replacement question, Q2. They were asked (in Q3A) to allocate any number from 0 through 100 to reflect the percentage of time they would listen to each particular option. Respondents were shown all of the services they said they would use to replace free or paid streaming radio in response to Q2. Zauberman WDT ¶ 64, 76.⁹⁹

The responses to Q3A indicated that current listeners of *free* streaming radio services who were asked to allocate their time indicated that they would replace 16 percent of the time they would have spent listening to their free streaming radio services by listening to paid streaming radio services, 32 percent of that time by listening to free On-Demand streaming services, 25 percent of that time by listening to paid On-Demand

⁹⁸ For example, respondents who took the survey on a Wednesday would be asked if they would expect to listen to their streaming radio service on the following Wednesday.

⁹⁹ The “day of week” variable was designed to function in the same manner as in Q3.

streaming services, 19 percent of that time by listening to Sirius XM satellite radio services on a satellite receiver, 27 percent of that time by listening to AM/FM radio on a traditional radio receiver, 18 percent of that time by listening to CDs, vinyl records, or MP3 files they currently own or would purchase, and 16 percent of that time by doing something other than listen to music. Zauberman WDT ¶ 26, 77, fig.10.

The responses to Q3A also indicated that current listeners of *paid* streaming radio services who were asked to allocate their time indicated that they would replace 24 percent of the time they would have spent listening to their paid streaming radio services by listening to free streaming radio services, 20 percent by listening to free On-Demand streaming services, 24 percent by listening to paid On-Demand streaming services, 21 percent by listening to Sirius XM satellite radio services on a satellite receiver, 18 percent by listening to AM/FM radio on a traditional radio receiver, 14 percent by listening to CDs, vinyl records, or MP3 files they currently own or would purchase, and 10 percent by doing something other than listen to music. Zauberman WDT ¶ 27, 78, fig.11.

b. Services' Criticisms of the Zauberman Survey

The Services offer a number of critiques of Professor Zauberman's surveys, including those noted below. Services PFFCL ¶¶ 288-302.

The Services assert that the survey erroneously toggles between an initial definition of "free streaming radio service" and an incorrect definition that described "on-line streams of AM/FM radio stations" as services that "allow you to listen to customized radio stations with advertisements," like Pandora. Services PFFCL ¶¶ 288-290, Proposed Findings of Fact and Conclusions of Law of the National Association of Broadcasters ¶¶

190-191 (NAB PFFCL), 8/27/20 Tr. 4245-51 (Zauberman).¹⁰⁰ The Services point out that in his hearing testimony, Professor Zauberman conceded that, contrary to the language of his erroneous definition, simulcasts are not customizable, and that including different definitions for the exact same term in a survey is not a best practice in his field. Services PFFCL ¶¶ 288-290; 8/27/20 Tr. 4246-47, 4253.

The Services also suggest Professor Zauberman's survey suffers from "cheap-talk" or hypothetical-bias problems. Services PFFCL ¶¶ 291-294. These concepts are described by Professor Hauser and Dr. Leonard as problems arising where respondents are allowed to choose multiple options, in which case they are more likely to select paid options that they would not in fact pay for in the real world, or otherwise do not really consider how much things cost or their budget constraint. Services PFFCL ¶ 291; 8/27/20 Tr. 4346-48 (Hauser); 8/24/20 Tr. 3421-23 (Leonard). Dr. Leonard also referenced academic literature addressing issues with the hypothetical nature of the "payment" in surveys, which can lead respondents to overstate their true willingness to pay. *See* Leonard WRT ¶¶ 19-21 & n.37 (citing Franziska Voelckner, *An Empirical Comparison of Methods for Measuring Consumers' Willingness to Pay*, 17 *MARKETING LETTERS* 137 (2006); James J. Murphy et al., *A Meta-analysis of Hypothetical Bias in Stated Preference Valuation*, 30 *ENVTL. RESOURCE ECON.* 313 (2005).). Dr. Leonard's testimony suggests that aspects of responses to Q3, the time allocation question, indicate that respondents would not actually pay for their survey selections in the real world.

¹⁰⁰ Q1: "A free streaming radio service, such as personalized radio services like free Pandora and free iHeart Radio, and on-line streams of AM/FM radio stations, where you cannot choose a specific song, and must listen to advertisements."

Q2: "Free streaming radio services—services, such as personalized radio services like free Pandora and free iHeart Radio, and on-line streams of AM/FM radio stations, allow you to listen to customized radio stations with advertisements, but you cannot choose a specific song."

Services PFFCL ¶ 291; Leonard WRT ¶ 21; 8/24/20 Tr. 3447-48 (Leonard) (addressing instances in which a service option was selected but no listening time was allocated to the option, a concept known in the economics literature as “hypothetical bias”).

The Services, through their expert witness Professor Hauser, suggest that the Zauberman Survey’s instruction to focus on music-listening options is biased and could suggest to respondents that the researcher was interested only in respondents switching to music-listening options, which could prompt respondents to favor the music-listening options rather than the stated option to do something other than listen to music. Professor Hauser points out the absence of specificity about what “do something other than listen to music” might entail and offers that respondents may not have immediately known, recalled, or considered alternatives that were available to them if they were not listening to music, leading them to select music-listening options instead. Services PFFCL ¶ 295; 8/27/20 Tr. 4364-65; Trial Ex. 2161 ¶¶ 7, 28-30 (WRT of John Hauser) (Hauser WRT).

The Services point to the Zauberman Survey’s inability to distinguish between a respondent who did not have an existing paid subscription and a respondent who had an existing paid subscription but did not use it in the past thirty days. This concern was highlighted by the testimony of Dr. Leonard and Mr. Harrison who both address the occurrence of consumers having inactive paid subscriptions. Services PFFCL ¶¶ 297-298; Leonard WRT ¶ 18; 9/3/20 Tr. 5732 (Harrison) (explaining how users who bill subscriptions through a credit card might have a service for months without realizing they were still a subscriber). Professor Hauser also criticizes the survey’s inability to distinguish between a respondent who did not have an existing paid subscription and a respondent who had an existing paid subscription but did not remember using it in the past thirty days. Services PFFCL ¶ 299. Professor Hauser stated that both academic research and his own survey pretest indicate that thirty days is too long for respondents to remember their own listening behavior accurately. The inability to distinguish between

respondents who did not have an existing paid subscription, or who had one but did not use it or remember using it in the past thirty days, likely resulted in an upward bias in estimated switching to new, paid subscriptions. Hauser WRT ¶¶ 24-27; *see also* 8/27/20 Tr. 4360.

The Services find fault with the Zauberman Survey's failure to allow respondents to distinguish between their listening to CDs, vinyl, or digital music files they owned already, and listening to CDs, vinyl, or digital files they would purchase. They point to Professor Zauberman conceding that a respondent who had a large existing collection of downloads or CDs would have no way of indicating that she would listen to her existing collection, rather than purchasing new CDs. Services PFFCL ¶ 300; 8/27/20 Tr. 4240. The Services point out that Professor Willig described the effect of this on the Zauberman Survey results as an "inaccuracy." Services PFFCL ¶ 300; 8/6/20 Tr. 843-47. The Services also note that both the Hauser and Hanssens surveys and industry data suggest that far more people would listen to existing collections than purchase new CDs or digital music files, suggesting that Professor Zauberman's survey likely would have demonstrated the same if he had given respondents the opportunity to make this distinction. *See* Hauser WRT ¶¶ 47-48; Trial Ex. 4095 tbls.4, 8 (CWDT of Dominique Hanssens) (Hanssens WDT); Leonard WRT ¶ 19; 8/24/20 Tr. 3448 (Leonard); Trial Exs. 2037, 2038, 2041 at 6 (showing declining sales and use of CDs and digital downloads).

The Services contend that the Zauberman Survey contained a fundamental error of failing to include attention checks to confirm respondents were sufficiently engaged in the survey and were providing reliable responses. *See* Hauser WRT ¶¶ 31-34. Professor Hauser explained that attention checks represent best practices in survey research, and not including them could have exacerbated the asserted flaws in the Zauberman Survey. *See id.* ¶¶ 8, 31-32; 8/27/20 Tr. 4334-35.

The Services suggest that some respondents in the Zauberman Survey who indicated they would listen to physical or digital recordings of music may in fact obtain pirated copies of recordings, thus calling into question the results. *See* 8/6/20 Tr. 799 (Willig); 8/10/20 Tr. 1089-92 (Willig). And, NAB takes issue with the Zauberman Surveys for not taking into account properly respondents who listened to zero hours of simulcasts. *See* NAB PFFCL ¶ 126.

c. Responses to Criticisms of the Zauberman Survey

In response to criticism of the Zauberman Survey, SoundExchange characterizes the altered definitional language as a “slight discrepancy,” noting that the word “customized” appeared only in introductory language, and not in any survey response option. SoundExchange offers that the Services provide no basis to conclude that the difference in definitions had any effect on Professor Zauberman’s data or that respondents were ever confused or noticed the discrepancy. SoundExchange suggests that the word “customized” in Q2 would not signal to respondents that AM/FM streaming was not a free streaming radio service because every time the survey describes free streaming radio services, it provides examples of services that fall into this category, including the example “on-line streams of AM/FM radio stations.” SoundExchange argues that if respondents had noticed and been confused by the variation in language, the survey results would have shown an increase of “unsure” responses with respect to free streaming radio services once alternate language was introduced, and that no such evidence of confusion exists. SX RPFCL (to Services) ¶¶ 288-290.

SoundExchange also suggests that Professor Zauberman adequately clarified in his testimony that simulcast listeners do have some ability to customize their experiences. Professor Zauberman testified that “there are multiple ways in which we customize our experiences or select the world around us” and that, with regard to opportunities to personalize on-line streams of AM/FM radio stations, station choice is one aspect of

customization. 8/27/20 Tr. 4271. SoundExchange then offers that other experts in this proceeding have a shared understanding of the functionality available through simulcasts. SX RPFCL (to Services) ¶ 288; 8/26/20 Tr. 4121-25 (Hanssens) (simulcasts of AM/FM broadcasts and free streaming radio services like Pandora are “very comparable mediums” that “share key attributes” and compete with one another).¹⁰¹

SoundExchange adds that Professor Zauberman’s testimony regarding variations in definitional language not constituting a best practice was not his ultimate conclusion. SX RPFCL (to Services) ¶ 290; 8/27/20 Tr. 4217 (Zauberman) (the suggested ultimate conclusion being that the Zauberman Survey provides the most reliable data of any survey or experiment in the proceeding and that its findings are highly consistent with the Hanssens and Simonson Surveys).

SoundExchange offers that Professor Hauser’s trial testimony regarding “cheap talk” is beyond the scope of his written testimony and unsupported by the academic literature he mischaracterized at trial. SX RPFCL (to Services) ¶ 291; SX PPFCL ¶¶ 1259-1261. SoundExchange adds that even if the asserted “cheap talk” effect did exist, the Services have not attempted to quantify it, with regard to Professor Zauberman’s survey or any other survey in this proceeding. SX RPFCL (to Services) ¶ 291. SoundExchange also offers that the critique of Q3 is misplaced, as a zero time allocation on one specific day in the following week is not unreasonable nor does it indicate that respondents would not actually pay for their survey selections in the real world. SX RPFCL (to Services) ¶ 292.

SoundExchange submits that Professor Zauberman’s focus on music listening was entirely appropriate in light of the focus and scope of this proceeding. It adds that

¹⁰¹ SoundExchange also references Orszag WRT ¶ 35 (given that users can choose to listen to a particular genre of music for both simulcast and custom radio, the user experience is not necessarily much different).

Professor Zauberman's approach struck an appropriate balance between providing a comprehensive list of options (including "do something other than listen to music") and the risk of making his survey unwieldy and confusing. SoundExchange points out that the Services offer no evidence that survey respondents actually had difficulty remembering what non-music options are available to them in the world. SX RPFCL (to Services) ¶¶ 295-296.

SoundExchange notes that Professor Zauberman's testimony indicates why he chose the survey format. With regard to respondents who may have had an existing paid subscription but did not use it in the past thirty days, Professor Zauberman designed the survey order to avoid ambiguity or complicating the survey and creating non-uniformity that risked privileging some options over others. SX RPFCL (to Services) ¶ 297; 8/27/20 Tr. 4181-82, 4184-85, 4239 (Zauberman). SoundExchange offers that Dr. Leonard's testimony that inactive subscriptions are "not uncommon" is poorly supported by the record. SoundExchange also criticizes, as conflicting, the NAB's argument that thirty days is too long for respondents to remember their own listening behavior accurately, and that thirty days is not long enough because a respondent may not have used his or her subscription service in the past 30 days SX RPFCL (to Services) ¶¶ 297-299. SoundExchange posits that the Services' critique regarding new versus existing physical copies of recordings flows from an unwarranted assumption: that respondents who would go back to their existing CD collections and start listening to them again would not also make new purchases in order to supplement their collections with new music. SX PPFCL ¶ 780; 8/6/20 Tr. 843-47 (Willig). It also points out that the Hanssens and Simonson Surveys, which do distinguish between new purchases and existing collections, find over twice the amount of diversion to new purchases of physical copies as the Zauberman Survey does. SX PPFCL ¶ 781, *Compare* Willig WDT ¶ 47, fig.6 (14.8% diversion to new CDs, vinyl records, and MP3s based on Zauberman Survey), *with* Trial

Ex. 5608 app. F at tbl.4B (CWRT of Itamar Simonson) (Simonson WRT) (comparing data from the Hanssens Pandora Survey, Simonson's Modified Hanssens Survey, and Hanssens Replication, reflecting a range of 27.8% to 29.9% diversion to new physical or digital recordings of music).

SoundExchange offers that all of the survey experts acknowledged that tools other than attention checks can be used to ensure that respondents are engaged in a survey and that such tools were used in the Zauberman Survey. SX PFFCL ¶¶ 766, 716-717.

SoundExchange also points to Professor Hauser's testimony on attention checks, which according to SoundExchange, indicates that attention checks are not currently viewed as required under best practices, noting his statement that attention checks are now "becoming widely used." SX PFFCL ¶ 766; 8/27/20 Tr. 4334-35 (Hauser).

Addressing criticism of the Zauberman Survey's failure to address the possibility that some respondents would in fact pirate sound recordings, SoundExchange observes that none of the surveys in the proceeding asks respondents whether they might obtain music through piracy. 8/10/20 Tr. 1118-19 (Willig). SoundExchange offers that there is no reason to think respondents would truthfully answer that they would engage in illegal activity. 8/26/20 Tr. 4143-44 (Hanssens). Moreover, Professor Hanssens made clear that he would not expect respondents to interpret the term "own" to encompass theft. *Id.* at 4142-43 (Hanssens). He also noted that the survey gave respondents options such as diverting listening to "other" sources, through which respondents could express their intent to steal recordings. *Id.* at 4143 (Hanssens).

SoundExchange suggests that while a number of respondents to the Zauberman Survey allocated zero time to a replacement option they had previously selected, any attempt to convert this observation into a critique misunderstands the structure of Professor Zauberman's time allocation questions. It offers that there is no inconsistency in respondents indicating that they would replace a noninteractive streaming service with

a particular music-listening option and also indicating that they do not expect to listen to that option on one specific day of the following week. SX PFFCL ¶ 784-785; 8/27/20 Tr. 4197-98 (Zauberman); 8/6/20 Tr. 848-50 (Willig). SoundExchange goes on to offer that the Services cite to no evidence to support the insinuation of inconsistency in the survey results. SX PFFCL ¶ 787.

d. Judges' Conclusions on the Zauberman Survey

Upon consideration of the entirety of the record, including the facts and arguments indicated above, on balance, the Judges find the Zauberman Survey to be reasonably reliable evidence. There is some validity to the criticisms regarding definitional inconsistency and diversion related to existing/owned physical recordings. However, viewed in light of the results of the other surveys, these criticisms of the Zauberman Survey seems to have had a minimal effect. At most, the criticisms go to the weight assigned to the Zauberman Survey results.

2. Share of Ear Report

Professor Willig used data from Edison Research's quarterly "Share of Ear" study as a secondary data source as a basis for fallback values inputted into his theoretical models, and as a sensitivity check to the Zauberman Survey. The Services assert that the Share of Ear data contain troublesome ambiguities. Services PFFCL ¶¶ 265-268; Leonard WRT ¶¶ 23-29.

SoundExchange responds to the criticism of the Share of Ear data by pointing out that such concerns have essentially been mooted. Professor Willig acknowledged at trial that, for purposes of computing diversion ratios and calculating opportunity cost, Share of Ear is "is not nearly as well founded ... as making use of the Hanssens Survey or the modified Hanssens Survey or the Zauberman Survey." SX RPFFCL (to Services) ¶ 265.

3. Hanssens Pandora Survey and Sirius XM Survey

a. Description of the Hanssens Surveys

i. Purpose and Design

Several experts relied, in part, on the results of the Hanssens Surveys. *See, e.g.*, Shapiro WDT at 16; 20-21, tbl.2; 28, tbl.5; Willig WRT ¶¶ 30-35. The Judges, therefore, test the underlying survey data on which he relied to assess their reliability or their strength in supporting various modeling conclusions.

Sirius XM and Pandora retained Professor Dominique Hanssens to conduct two consumer surveys—the “Pandora Survey” and the “Sirius XM Survey. The Hanssens Surveys measured how consumers would respond if their noninteractive streaming services changed by the loss of access to any given record company’s repertoire, including what alternative sources of music, if any, listeners of free Internet radio services music on Sirius XM over the Internet would change their listening to as a result of hypothetical loss of music options. Hanssens WDT ¶¶ 13, 33, 39-40 & app. 6. The Pandora Survey addressed listeners of free Internet radio and his Sirius XM Survey addressed listeners of Sirius XM’s subscription webcasting service. *Id.* ¶ 20. The two surveys pose comparable hypotheticals and proceed in parallel. *Id.* ¶¶ 33, 66 & Apps. 6 & 12.

Professor Hanssens sought to answer the following questions: (a) whether listeners would change their listening if they were dissatisfied because music selection across the category was “degraded” as described in the hypothetical given to respondents¹⁰², (b) whether listeners would change their listening to alternative sources of

¹⁰²The study considered the hypothetical that services were limited by the loss of access to any given record company’s repertoire, which was addressed in the survey by asking respondents what they would do in the event that they noticed all relevant services stopped streaming songs by some popular artists and some

music (as opposed to non-music) in that instance, (c) which alternative sources of music they would increase listening to, if any, and (d) how listeners would allocate increased listening, if any, across the alternative music sources they identified).¹⁰³ *Id.* ¶¶ 21-22.

The Pandora Survey indicated that 60.1 percent of the sample of listeners of free Internet radio services would decrease listening to free Internet radio services in the event that the music selection across all free Internet radio services were degraded. Of the respondents who indicated that they would decrease listening to free Internet radio services or listen to free Internet radio about the same amount, 63.5 percent would increase listening to alternative sources of music under this scenario. When forced to make a tradeoff between multiple options of alternative sources of music, the sample of listeners indicated that they would increase their watching or listening to music in videos on YouTube or social media the most (11.6 points on average), followed by listening to live radio broadcasts of music through a radio (9.8 points on average), and then followed by listening to music on a new free On-Demand music streaming service (7.7 points on average). *Hanssens WDT* ¶ 18.¹⁰⁴

The Sirius XM Survey indicated that 36 percent of the sample of listeners of music on Sirius XM over the Internet would decrease their listening to that service in the event that the music selection available on that service were degraded. Of the

newly released music. *Hanssens WDT* ¶¶ 13, 21-22. This approach was intended for the focus to be on cases where that change in music availability is noticed and therefore generates responses to that specific scenario, as opposed to the more general scenario of simple label suppression. 8/26/20 Tr. 4091 (*Hanssens*).

¹⁰³ The *Hanssens* survey thus posits a *degradation* of a listening option (*i.e.*, loss of repertoire), as distinguished from the *Zauberman* survey, which posited the *unavailability* of a listening option.

¹⁰⁴ Respondents were asked to allocate 100 points across the alternative music sources they previously selected based on how much they would listen to these different sources. *Hanssens WDT* app. 12.

respondents who indicated that they would decrease listening to music on Sirius XM over the Internet or listen to about the same amount of music on that service, 58.9 percent would increase listening to alternative sources of music under this scenario. When forced to make a tradeoff between multiple options of alternative sources of music, by an allocation of points on average, the sample of listeners indicated that most of their increased listening would be on an existing Sirius XM satellite radio subscription. Hanssens WDT ¶ 19.

Professor Hanssens's surveys were conducted by respondents on a traditional desktop computer, laptop notebook computer, or tablet computer. The surveys included several screening questions. Qualified respondents had to pass several standard attention check questions and satisfy certain demographic quotas to ensure the survey respondents were not statistically different from the typical demographics of Pandora or Sirius XM on the Internet users, depending on the particular survey. The survey response rate, completion rate, and incidence rate were all within the typical range for internet surveys, and the sample size was large enough to draw conclusions regarding the key questions posed in the survey. Additionally, the survey was extensively pretested. *Id.* ¶¶ 26-29, 36-37, 56-59, 65-67.

Professor Hanssens applied other quality assurance measures designed to ensure that respondents provided informed and reliable responses. In the Pandora Survey, prior to the first substantive question (P20), Professor Hanssens provided respondents with descriptions and well-known examples of free Internet radio, On-Demand Music Streaming, and Paid Internet Radio categories. *Id.* ¶ 32. Additional preliminary questions helped identify the target population for the Pandora Survey and were designed to provide respondents with an accurate set of alternative music options in the main questionnaire, in which they were asked to identify services they would listen to more if the music selection on free Internet radio services were degraded. *Id.* ¶ 30.

ii. Pandora Survey Results

In order to assess which alternative sources of music respondents would choose in the event that a webcaster lost access to a particular record company's repertoire, Professor Hanssens instructed respondents, "Imagine you were not satisfied with [a free Internet radio service the respondent indicated listening to in a typical week] because you noticed that it had stopped streaming songs by some of your favorite artists and some newly released music. Imagine that all other free Internet radio services stopped streaming those same songs as well." Hanssens WDT ¶ 33; 8/26/20 Tr. 4091 (Hanssens) (explaining that this language is intended for the focus to be on cases where that change in music availability is noticed and therefore generates responses to that specific scenario, as opposed to the more general scenario of simple label suppression).

The Hanssens Pandora survey then proceeded as follows.

Respondents were asked (in question P20), "Which of the following actions, if any, would you consider taking in the event that you were not satisfied with free Internet radio services because their selection of songs changed in this way?" The survey offered the following answer choices: "I would use free Internet radio services less; I would use free Internet radio services about the same amount; I would use free Internet radio services more; Don't know/unsure." *Id.* ¶¶ 34, 39; Appendix 7 at 120; 8/26/20 Tr. 4097 (Hanssens).

Among the 506 respondents to question P20, 60.1 percent responded that they would use free Internet radio services less, 35.8 percent responded that they would use free Internet radio services about the same, and 4.2 percent responded that they did not know or were unsure about how their listening habits would change. Hanssens WDT ¶ 40.¹⁰⁵ Those who indicated that they did not know or were unsure about how their

¹⁰⁵ The results of P20 are reported in Table 1.

listening habits would change were not included in subsequent calculations as it is not possible to know what they would do if the music selection across all free Internet radio services were degraded. Hanssens WDT ¶ 40 n.46.

Respondents who indicated that they would listen to free Internet radio services less or about the same amount were asked question P30: “Which other actions from the following, if any, would you consider taking in the event that you were not satisfied with free Internet radio services because their selection of songs changed in this way?” Those respondents were provided the following two categories: “Consume non-music entertainment content” and “Listen to music using ways other than free Internet radio” and, for each, were asked whether they would “increase doing this, make no changes to how much I do this, decrease doing this, don’t know/unsure.” *Id.* ¶¶ 34, 42, Appendix 7 at 121.

In hearing testimony Professor Hanssens noted that, while the non-music options (and descriptive examples) were presented “for completeness reasons,” the results were not used as they are “not the focus of [the] work.” 8/26/20 4097-98 (Hanssens).

The results of P30 are reported in Table 2, below.

Table 2
Summary of Responses to Question P30 on Pandora Survey

	Number of Respondents	Percentage of Respondents
Listen to music using ways other than Free Internet Radio		
Increase doing this	308	63.5%
Make no changes	124	25.6%
Decrease doing this	38	7.8%
Don't know/unsure	15	3.1%
Total	485	100.0%
Consume non-music entertainment content		
Increase doing this	191	39.4%
Make no changes	260	53.6%
Decrease doing this	16	3.3%
Don't know/unsure	18	3.7%
Total	485	100.0%

Source: GBH Data

Note: Question P30 reads: "Which other actions from the following, if any, would you consider taking in the event that you were not satisfied with Free Internet Radio services because their selection of songs changed in this way?"

Id. ¶ 42.

In the analyses that followed question P30, the 53 respondents who indicated in that they would listen to alternative sources of music less (35) or who did not know or were unsure about whether they would change their music consumption (15) were excluded. Hanssens WDT ¶ 43 n.50.

Respondents who indicated that they would increase listening to alternative sources of music were asked question P40: "In which of the following ways, if any, would you increase listening to music in place of free Internet radio in a typical week?" Respondents were then provided specific alternative music sources to which they would consider increasing their listening, including the types of services the respondents had previously responded they were already using in their responses to the screening questions. Hanssens WDT ¶¶ 34. 46-48, Appendix 7 at 122; 8/26/20 Tr. 4098 (Hanssens).

The results of P40 are reported in Table 3, below.

Table 3
Summary of Responses to Question P40 on Pandora Survey

Respondents indicated that they would increase listening to music via...	Number of Respondents	Percentage of Respondents
A new free On-Demand music streaming service they do not already use	198	45.8%
A free On-Demand music streaming service they already use	88	20.4%
A new paid On-Demand music streaming service they do not already use	92	21.3%
A paid On-Demand music streaming service they already use	127	29.4%
A new Paid Internet Radio service they do not already use	115	26.6%
A Paid Internet Radio service they already use	25	5.8%
A new Sirius XM subscription and through a satellite radio receiver	55	12.7%
An existing Sirius XM subscription and through a satellite radio receiver	54	12.5%
A new Sirius XM subscription and through Sirius XM over the Internet	66	15.3%
An existing Sirius XM subscription and through Sirius XM over the Internet	52	12.0%
New purchases of physical or digital recordings of music	129	29.9%
Physical or digital recordings of music they already own	213	49.3%
Borrowed copies of music recordings	113	26.2%
Live radio broadcasts of music through a radio	222	51.4%
Music channels through a cable or satellite television subscription	174	40.3%
Videos on YouTube or social media	241	55.8%
Other [Please specify _____]	7	1.6%
Total	432	

Source: GBH Data

Note: Question P40 reads: "In which of the following ways, if any, would you increase listening to music ["in place of Free Internet Radio" IF RESPONDENT ANSWERED "I would use Free Internet Radio services less" FROM Question P20] in a typical week? The 432 respondents in Table 3 include 124 respondents who indicated in Question P30 that they would not change how much they would listen to music using ways other than Free Internet Radio in the event that the music selection across all Free Internet Radio services were degraded. These respondents are treated as having indicated that they would not increase listening to any of the options in Question P40.

Hanssens WDT ¶ 49.

The final substantive question, P50, presented respondents who had responded to question P40 that they would increase listening to multiple alternative music sources with the alternative music sources they selected in P40 and instructed them to "Please divide 100 points across the different ways of listening to music based on how much you think you would use each alternative in a typical week." *Id.* ¶¶ 34, 52, Appendix at 123. This question was designed to allow the individual listener to rank the relative importance of answer options. 8/26/20 Tr. 4098 (Hanssens). Professor Hanssens explained that he asked this question in terms of point allocations rather than in absolute time or percentages of time in order to avoid the cognitively difficult "quantification of time," and to better assess relative importance, which may be obscured by absolute expressions of time. 8/26/20 Tr. 4099 (Hanssens).

The results of P50 are reported in Table 4, below.

Table 4
Summary of Responses to Question P50 on Pandora Survey

Respondents indicated that they would increase listening to music via...	Number of Respondents	Percentage of Respondents	Average Number of Points Allocated Across All Responses	Standard Error
A new free On-Demand music streaming service they do not already use	178	41.2%	7.7	0.7
A free On-Demand music streaming service they already use	81	18.8%	3.7	0.5
A new paid On-Demand music streaming service they do not already use	82	19.0%	4.0	0.6
A paid On-Demand music streaming service they already use	112	25.9%	5.4	0.7
A new Paid Internet Radio service they do not already use	102	23.6%	4.2	0.5
A Paid Internet Radio service they already use	22	5.1%	0.8	0.2
A new Sirius XM subscription and through a satellite radio receiver	42	9.7%	1.5	0.3
An existing Sirius XM subscription and through a satellite radio receiver	49	11.3%	2.4	0.4
A new Sirius XM subscription and through Sirius XM over the Internet	55	12.7%	1.4	0.2
An existing Sirius XM subscription and through Sirius XM over the Internet	48	11.1%	1.7	0.3
New purchases of physical or digital recordings of music	106	24.5%	2.7	0.3
Physical or digital recordings of music they already own	196	45.4%	7.0	0.6
Borrowed copies of music recordings	96	22.2%	2.0	0.3
Live radio broadcasts of music through a radio	201	46.5%	9.8	0.8
Music channels through a cable or satellite television subscription	155	35.9%	4.6	0.4
Videos on YouTube or social media	232	53.7%	11.6	0.8
Other [Please specify _____]	10	2.3%	0.4	0.2
Total	432			

Source: GBH Data

Note: Question P50 reads: "Please divide 100 points across the different ways of listening to music based on how much you think you would use each alternative in a typical week." The 432 respondents in Table 4 include 124 respondents who indicated in Question P30 that they would not change how much they would listen to music using ways other than Free Internet Radio in the event that the music selection across all Free Internet Radio services were degraded. These respondents are treated as having entered zero points to all of the options in Question P50.

Hanssens WDT ¶ 53.

4. Simonson's Replicated and Modified Hanssens Surveys

a. Description of the Simonson Surveys

SoundExchange also engaged Professor Simonson to assess the testimony of several witnesses, including Professor Hanssens. As part of that task, Professor Simonson ran a replication of the Hanssens Pandora Survey (Hanssens Replication survey), as well as a modified version of that survey (Modified Hanssens survey).

Simonson WRT ¶ 12.

Professor Simonson adopted the same methodology and screening criteria that Professor Hanssens used in the Hanssens Pandora Survey. *Id.* ¶¶ 88; 8/27/20 Tr. 4282-83 (Simonson). The Modified Hanssens survey retained all aspects of the original Pandora survey, except it omitted any mention of user dissatisfaction. The Modified Hanssens survey modified the instructions given to respondents, which Professor Hanssens had intended to focus on cases where listeners noticed the change in music availability. Professor Simonson made the change out of concern that one may assume that the Hanssens Surveys' results apply only to those listeners who would have been dissatisfied

by the change in repertoire, perhaps relying on the Reiley Label Suppression Experiments to support assumptions that very few users would in fact be dissatisfied and change their listening. Therefore, the scenario changed from:

Imagine that you were not satisfied with this service because you noticed that it had stopped streaming songs by some of your favorite artists and some newly released music. Imagine that all other free Internet radio services stopped streaming those same songs as well.

to

Imagine that this service stopped streaming songs by some of your favorite artists and some newly released music. Imagine that all other free Internet radio services stopped streaming those same songs as well.

Simonson WRT ¶¶ 94-95. The Modified Hanssens survey also removed the instruction that “you were not satisfied” in other places throughout the survey. *Id.* ¶¶ 94-96.

Additionally, in the Modified Hanssens survey, for those respondents who indicated that they “would use free Internet radio services less” in the hypothetical scenario, respondents were asked an additional question, intended to allow analysis of the magnitude of these respondents’ likely change in listening:

You indicated that you would use free Internet radio services less in the event that all free Internet radio services had stopped streaming songs by some of your favorite artists and some newly released music. In that case, how much less time would you spend listening to free Internet radio services in a typical week?

Select one only.

1. 1-9% less
2. 10-24% less
3. 25-49% less
4. 50-74% less
5. 75-99% less
6. 100% less
7. Don’t know/unsure

Simonson WRT ¶ 89.

Professor Simonson indicated at trial that the results of the Replication survey and Modified Hanssens survey indicate that the Hanssens Pandora Survey is reliable because it can be replicated with a different panel and at a different time of year. 8/27/20 Tr. 4283 (Simonson). Additionally, Professor Simonson stated that “removing the ‘you are unsatisfied’ instruction from the Modified Hanssens Survey did not generally result in large alterations to the data, relative to either the original Pandora Survey or the Replication Survey. This similarity indicates that the survey data largely applies to all relevant listeners, not only to the subgroup who would be dissatisfied with a change in repertoire.” Simonson WRT ¶ 99 (footnote omitted).

The results of the respective surveys regarding the actions respondents would take if free Internet radio services were degraded (Hanssens question P20) are reflected below.¹⁰⁶

¹⁰⁶ Professor Simonson’s analysis of the Hanssens survey data only included the respondents who were not excluded by reason of their responses to the screening questions and P20 and P30, as described above, the number of such respondents totaling 432. The total number of qualifying respondents in the Replication survey was 424. The total number of qualifying respondents in the Modified Hanssens survey was 372.

Table 1B.
Comparison of Simonson and Hanssens Results
Q20/120/220 Responses, Qualifying Respondents Only

	Hanssens	Simonson		Hanssens	Simonson	
		Cell 1	Cell 2		Cell 1	Cell 2
<i>I would consider using Free Internet Radio Services...</i>				N = 432	N = 424	N = 372
Less	267	270	232	61.8%	63.7%	62.4%
About the same amount	165	154	140	38.2%	36.3%	37.6%
More	0	0	0	0.0%	0.0%	0.0%
Don't know/Unsure	0	0	0	0.0%	0.0%	0.0%
Total	432	424	372	100.0%	100.0%	100.0%

Notes and Sources:

[1] Only respondents who chose "Less" or "Same" in Q20, "More" or "Same" in Q30 (for music), and "4" in Q60 were included in this analysis.

[2] Q20: Which of the following actions, if any, would you consider taking in the event [that you were not satisfied with Free Internet Radio Services because their selection of songs changed in this way/that Free Internet Radio Services' selection of songs changed in this way]?

[3] Hanssens results were from "Pandora Raw ALL STARTS.xlsx", and Simonson results were from "12.11.19_N1075 - 19077 Music Survey Daily Data Export.xlsx."

Simonson WRT ¶ 98.

The results of the respective surveys regarding other actions, if any, respondents would consider taking in the event that free Internet radio services were degraded (original Hanssens question P30) are reported below. Simonson WRT 244.

Table 3B.
Comparison of Simonson and Hanssens Results
Q30/130/230 Responses, Qualifying Respondents Only

	Total Respondents			Percent of Respondents		
	Hanssens	Simonson		Hanssens	Simonson	
		Cell 1	Cell 2		Cell 1	Cell 2
<i>I would consider...</i>				N = 432	N = 424	N = 372
Listening to music using ways other than Free Internet Radio						
More	308	308	250	71.3%	72.6%	67.2%
Same amount	124	116	122	28.7%	27.4%	32.8%
Less	0	0	0	0.0%	0.0%	0.0%
Don't know/Unsure	0	0	0	0.0%	0.0%	0.0%
Consuming non-music entertainment content						
More	168	156	136	38.9%	36.8%	36.6%
Same amount	240	233	204	55.6%	55.0%	54.8%
Less	12	15	14	2.8%	3.5%	3.8%
Don't know/Unsure	12	20	18	2.8%	4.7%	4.8%
Total	432	424	372	100.0%	100.0%	100.0%

Notes and Sources:

- [1] Only respondents who chose "Less" or "Same" in Q20, "More" or "Same" in Q30 (for music), and "4" in Q60 were included in this analysis.
[2] Q30: Which other actions from the following, if any, would you consider taking in the event [that you were not satisfied with Free Internet Radio Services because their selection of songs changed in this way/that Free Internet Radio Services' selection of songs changed in this way]?
[3] Hanssens results were from "Pandora Raw ALL STARTS.xlsx", and Simonson results were from "12.11.19_N1075 - 19077 Music Survey Daily Data Export.xlsx."

The results of the respective surveys regarding which of the following ways, if any, respondents would increase listening to music in place of free Internet radio in a typical week (original Hanssens question P40) are reflected below.

Table 4B.
Comparison of Simonson and Hanssens Results
Q40/140/240 Responses, Qualifying Respondents Only

	Hanssens	Simonson	
		Cell 1	Cell 2
<i>In place of [listening to] Free Internet Radio in a typical week, I would...</i>	N = 432	N = 424	N = 372
Sign up for and listen to a new free On-Demand music streaming service with ads	45.8%	48.8%	40.1%
Listen more to a free On-Demand music streaming service with ads	20.4%	21.2%	22.3%
Purchase a new subscription for an ad-free On-Demand	21.3%	21.9%	12.4%
Listen more to an ad-free On-Demand music streaming service	29.4%	30.9%	32.8%
Purchase a new subscription for an ad-free Paid Internet Radio service	26.6%	23.3%	16.9%
Listen more to an ad-free Paid Internet Radio service	5.8%	5.0%	2.7%
Purchase a new Sirius XM subscription and listen to music on Sirius XM through a satellite radio receiver	12.7%	8.3%	5.6%
Use an existing Sirius XM subscription and listen to music on Sirius XM through a satellite radio receiver	12.5%	13.0%	15.1%
Purchase a new Sirius XM subscription and listen to music on Sirius XM over the internet	15.3%	12.0%	8.9%
Use an existing Sirius XM subscription and listen to music on Sirius XM over the internet	12.0%	13.0%	14.5%
Purchase new physical or digital recordings (downloads) of music	29.9%	27.8%	29.0%
Listen more to physical or digital recordings (downloads) of music I already own	49.3%	51.2%	49.5%
Listen to borrowed copies of recordings from friends, family, or the public library	26.2%	26.2%	22.0%
Listen to live radio broadcasts of music from radio stations through a radio	51.4%	55.2%	50.8%
Listen more to music channels I have access to as part of a cable or satellite television subscription	40.3%	44.3%	33.6%
Watch or listen to music in videos on websites such as YouTube or through social media	55.8%	56.1%	55.4%
Other	1.6%	1.4%	2.2%

Notes and Sources:

- [1] Only respondents who chose "Less" or "Same" in Q20, "More" or "Same" in Q30 (for music), and "4" in Q60 were included in this analysis.
[2] Q40/140/240: In which of the following ways, if any, would you increase listening to music in place of Free Internet Radio in a typical week?
[3] Hanssens results were from "Pandora Raw ALL STARTS.xlsx", and Simonson results were from "12.11.19_N1075 - 19077 Music Survey Daily"

Simonson WRT ¶ 98.

The Modified Hanssens survey results for regarding the magnitude of respondents' likely change in listening (Q225) are reflected below.

Table 2B.
Summary of Responses to Simonson's Additional Question
Simonson Q225 Responses, Qualifying Cell 2 Respondents Only

<i>I would use Free Internet Radio Services...</i>	N	%
1 - 9% less	4	1.7%
10 - 24% less	33	14.2%
25 - 49% less	54	23.3%
50 - 74% less	77	33.2%
75 - 99% less	35	15.1%
100% less	21	9.1%
Don't know/unsure	8	3.4%
Total	232	100.0%

Notes and Sources:

[1] Only respondents who chose "Less" or "Same" in Q20, "More" or "Same" in Q30 (for music), and "4" in Q60 were included in this analysis.

[2] Q225: You indicated that you would use Free Internet Radio Services less in the event that all Free Internet Radio Services had stopped streaming songs by some of your favorite artists and some newly released music. In that case, how much less time would you spend listening to Free Internet Radio Services in a typical week?

[3] Simonson results were from "12.11.19_N1075 - 19077 Music Survey Daily Data Export.xlsx".

Simonson WRT 243.

b. Criticisms of the Hanssens Surveys

SoundExchange engaged Professor Itamar Simonson to examine whether the Hanssens surveys were likely to produce unbiased, reasonably accurate estimates regarding the impact of a loss of access to any given record company's repertoire on listening to the free Internet radio services at issue and on switching to alternative sources of music. Simonson WRT ¶ 66. While Professor Simonson found the Hanssens surveys relatively reliable, he asserted the surveys contained several flaws. Simonson WRT ¶¶ 64-65. SoundExchange also engaged Professor Zauberman to examine the Hanssens Surveys calculation. Trial Ex. 5607 ¶¶ 1-2 (WRT of Gal Zauberman) (Zauberman WRT).

Professor Simonson criticized the Hanssens survey questions for mixing music with unrelated categories, such as videogames and movies, leading to a "diversification bias," which allegedly encouraged respondents to select to non-music switching options and an underestimation of switching from one music service to another. He pointed to research, demonstrating that the mere fact that respondents are presented simultaneously

with multiple options causes them to spread their choices among the options instead of choosing only the option they like most. He indicated that a survey designer can decrease the percentage of respondents who indicate they will switch from one music service to another by presenting respondents with options from a wide range of options and that the Hanssens Surveys do just that by leading respondents to consider a wide set of switching options, including options that are unrelated to music. Simonson WRT ¶¶ 67-74 (citing Itamar Simonson, *The Effect of Purchase Quantity and Timing on Variety Seeking Behavior*, 27 J. MARKETING RESEARCH 150 (1990); Daniel Read & George Loewenstein, *Diversification Bias: Explaining the Discrepancy in Variety Seeking Between Combined and Separated Choices*, 1 J. EXPERIMENTAL PSYCHOL.: APPLIED 34 (1995); and Schlomo Benartzi & Richard H. Thaler, *Naive Diversification Strategies in Defined Contribution Saving Plans*, 91 AM. ECON. REV. 79 (2001); and Craig R. Fox, David Bardolet & Daniel Lieb, *How Subjective Grouping of Options Influences Choice and Allocation: Diversification Bias and the Phenomenon of Partition Dependence*, 134 J. EXPERIMENTAL PSYCHOLOGY: GEN. 538 (2005); Craig R. Fox, David Bardolet & Daniel Lieb, *Partition Dependence in Decision Analysis, Resource Allocation, and Consumer Choice*, 3 EXPERIMENTAL BUS. RESEARCH 229 (2005)).

Professor Simonson also took issue with the sequence of Hanssens survey questions. He criticized the surveys for asking about the various options the respondents may consider before asking them to select among those options. In Professor Simonson's opinion, informed by published research, asking respondents to consider a long list of options biases the respondents' subsequent responses. He opined that while offering such "consideration set" options may be appropriate in scenarios involving costly and often relatively irreversible decisions, it is not appropriate in the context of selecting a music service, which involves low cost, low risk, and easily changed purchase decisions. Relatedly, Professor Simonson suggested that research suggests that an unrealistic

consideration set can also create bias in follow-up questions such that the list of considered options is likely to influence subsequent choices made by respondents.

Simonson WRT ¶¶ 75-81 (citing Barbara E. Kahn & Donald R. Lehmann, *Modeling Choice Among Assortments*, 67 J. RETAILING 274 (1991); Itamar Simonson, *The Effect of Product Assortment on Consumer Preferences*, 75 J. RETAILING 347 (1999); Armin Falk & Florian Zimmermann, *A Taste for Consistency and Survey Response Behavior*, 59 CESIFO ECON. STUDIES, no.1, 181 (2012); and Itamar Simonson, *The Effect of Buying Decisions on Consumers' Assessments of Their Tastes*, 2 MARKETING LETTERS 5 (1991)).

Professor Simonson indicated that the Hanssens Surveys ignored the impact that a change in repertoire would have on services' ability to attract new users. He noted that while Hanssens Surveys attempted to measure whether existing service users might change their listening behavior, the surveys did not examine or attempt to quantify the impact of offering a more limited music repertoire on a services' ability to attract new users. Professor Simonson posited that ignoring the impact on potential users, Professor Hanssens understated the impact that the loss of a label's content would have on the relevant services. Simonson WRT ¶¶ 82-84. SoundExchange also notes that this focus on existing customers indicates that the surveys at most measure only part of the impact that losing a record label would have on these services. SX PFFCL ¶ 788.

Professor Zauberman faulted the Hanssens surveys for not allowing respondents to respond on their smartphones, despite the fact that a large proportion of users stream music via smartphone. Zauberman WRT ¶¶ 82-88. He noted that other relevant surveys could be completed on smartphones and suggested that those surveys tended to have younger participants who are likely to listen to more music, and to replace Free Streaming Radio with Paid streaming services at higher rates than those who took the survey on other devices. Zauberman WRT ¶¶ 86-88. SoundExchange alleges that this

may cause any calculation of diversion ratios based on the Hanssens surveys to be conservative. SX PFFCL ¶ 758.

Professor Zauberman asserted that the Hanssens surveys were confusing for respondents, offering that survey practices dictate that hypotheticals should be posed simply, not as instructions about how respondents should feel. He added that the surveys contained too many response options that are overly wordy, making it difficult for a respondent to keep track of all relevant information. Professor Zauberman alleged that respondents were presented with too many response options that were zero-royalty options causing the responses to be biased towards such zero-royalty options. He also faulted the surveys for use of the typical week as a timeframe for respondents as being contrary to best survey design practices, and suggested that a time frame described as “a typical week” may be ambiguous to some respondents. Zauberman WRT ¶¶ 88-95.

c. Responses to Criticisms of the Hanssens Surveys

In response to criticism of the Hanssens surveys, Pandora/Sirius XM offers, in part, that Professor Simonson demonstrated convincingly that the Hanssens surveys were reliable by replicating them using an entirely new sample, and obtaining very similar results. Pandora and Sirius XM's Corrected Proposed Findings of Fact and Conclusions of Law ¶ 111 (Pandora/Sirius XM PFFCL). Pandora/Sirius XM offers that the Hanssens surveys actually overestimate diversion, in that his scenario contemplates the loss of consumers' favorite artists, which does not necessarily simulate real-world conditions given that the loss of a label may not be coincident with the loss of all of the works of an artist and may not be coincident with the loss of a favorite artist. Pandora/Sirius XM PFFCL ¶ 112; 8/26/20 Tr. 4091-96, 4099-4101 (Hanssens). Pandora/Sirius XM adds that the Hanssens surveys reflect only the subset of Pandora users who would actually be affected by the degradation in the sense that they noticed it and were dissatisfied as a

result, not simply any Pandora user subject to the suppression. 8/26/20 Tr. 4093, 4101, 4154-56.

Pandora/Sirius XM notes that Professor Hanssens did not actually use the non-music data but, rather, included it merely for completeness reasons. Pandora/Sirius XM PFFCL ¶ 115. Pandora/Sirius XM also states that no empirical analysis of alleged diversification bias was offered. Instead, they indicate, Professor Simonson only offered citations to academic articles discussing the phenomenon. Pandora/Sirius XM PFFCL ¶ 114. Similarly, Pandora/Sirius XM indicates that Professor Simonson did not offer any empirical evidence to support his critique that the sequence of Professor Hanssens's questions, requiring respondents to consider options before choosing them, could have biased his results. Pandora/Sirius XM PFFCL ¶ 116. Pandora/Sirius XM adds that the survey was designed to minimize any confusion, including instructing respondents to take their time reviewing the questions and providing a link to the descriptions and examples in every subsequent question. Pandora/Sirius XM PFFCL ¶ 110. Additionally, Pandora/Sirius XM clarifies that the intent of the Hanssens survey was to evaluate the behavior of listeners, not potential listeners. Pandora/Sirius XM PFFCL ¶ 117. The Services also observe a lack of empirical evidence that a failure to conduct the surveys on smartphones had any effect on the results. Services RPFCL ¶ 760.

d. Criticism of Professor Simonson's Modified Hanssens Surveys

Pandora Sirius XM offers that Professor Simonson conceded that his modified surveys, designed to test the impact of including language of explicit dissatisfaction, did not, generally, result in large alterations to the data relative to either the original Pandora Survey or the Replication Survey. Pandora/Sirius XM PFFCL ¶ 118; Simonson WRT ¶ 99; 8/27/20 Tr. 4285 (Simonson); *id.* at 4315-16; 8/26/20 Tr. 4094 (Hanssens) (noting same). Pandora Sirius XM points out that both Professor Simonson and Professor Hanssens agreed that this lack of impact on Professor Hanssens's survey is likely due to

the fact that dissatisfaction is implicit in a hypothetical referencing the loss of some of respondents' favorite artists and some newly released music. Pandora/Sirius XM PFFCL ¶ 119.

Pandora Sirius XM indicates that Professor Simonson's question 225, intended to allow analysis of the magnitude of respondents' likely change in listening, is flawed and unreliable. Pandora/Sirius XM PFFCL ¶ 122. Professor Hanssens posited that the question does not accurately measure the likely change in listening. He asserts that the loss of a particular label fundamentally differs from the loss of favored artists or newly released music because artists are presented on more than one label, and many people do not know which labels represent which artists. 8/26/20 Tr. 4092-96 (Hanssens). He adds that the question is limited to people who actually notice the change and are negatively affected by it, which he notes is not coincident with all Pandora listeners. And, he offers that, without a proper basis for a respondent's volume of listening, it is not possible for a respondent to generate a reliable response on the amount that would be lost. 8/26/20 Tr. 4096 (Hanssens). Finally, Professor Hanssens criticizes the answer ranges offered in Question 225, asserting that they are so wide and unequal that they are imprecise, biased, and unreliable. 8/26/20 4096 (Hanssens).

e. Responses to Criticisms of Professor Simonson's Modified Hanssens Surveys

SoundExchange counters that the criticism of the language of explicit dissatisfaction is essentially an acknowledgment that there is no need to instruct respondents to imagine they are dissatisfied by label blackout because dissatisfaction follows naturally from the loss of content. SX RPFCL (to Pandora/Sirius XM) ¶ 119.

SoundExchange indicates that any notion that the loss of a label differs fundamentally from loss of favored artists or newly released music is unsupported by the evidence and contrary to Professor Hanssens's own testimony, including his describing

the loss of access to any given record company's repertoire. SX RPFCL (to Pandora/Sirius XM) ¶ 122, 112. SoundExchange rejects the notion that the survey is limited to a subset of users, instead asserting that it addresses aggregate consumer reaction in the event consumers are aware of label blackout, as they would be in any real world circumstance. SX PPFCL (to Pandora/Sirius XM) ¶ 122. Finally, SoundExchange offers that the suggestion that respondents should have been asked to report their current listening time is undermined by the fact that allocations of absolute time are notoriously difficult for respondents to answer. SX RPFCL (to Pandora/Sirius XM) ¶ 122.

f. Judges' Conclusions Regarding the Hanssens and Simonson Surveys

Upon consideration of the entirety of the record, including the facts and arguments indicated above, on balance, the Judges find the Hanssens Pandora Survey as well as the Simonson's Replicated and Modified Hanssens Surveys to be probative as to diversion behaviors of listeners of noninteractive streaming services regarding a loss of content and on switching to alternative sources of music. Notwithstanding the criticisms of the surveys, the Judges find the overall conduct of the surveys to have been rigorous and generally faithful to applicable best practices. Further, the replication and modification of the surveys, with generally consistent results, reinforce the Judges' finding that the collective results are probative in this proceeding. The Judges find that Professor Simonson's modifications (removing indications of dissatisfaction) ultimately had little impact on the results. Additionally, the Judges are persuaded that the issues raised regarding question 225 in the modified Hanssens survey, especially the criticism of the response ranges and interpretation of them, while not completely discounting of the results, do have merit. Therefore, the Judges rely more heavily on the results of the two consistent and replicated surveys.

The overall structure of the Sirius XM survey was the same as the structure of the Pandora survey, and Professor Hanssens simply substituted "Sirius XM over the Internet"

for “free Internet radio services” where necessary. Hanssens WDT ¶ 59. It included 150 respondents, with only 131 non-excluded respondents. Hanssens WDT ¶ 70 n.93. SoundExchange alleges that the sample size of Professor Hanssens’s Sirius XM Survey was very small, making the results imprecise. Zauberman WRT ¶ 96. Professor Zauberman’s analysis of Professor Hanssens’s Sirius XM Survey indicated confidence intervals that are extremely wide. Professor Zauberman testified that the level of imprecision is problematic, especially when the estimates are then used for subsequent analyses. *Id.*, citing Table 6. Pandora/Sirius XM asserts that the sample size of the Sirius XM survey was sufficient to draw statistically valid conclusions. Pandora/Sirius XM PFFCL ¶ 109. The Judges agree with the critique of the sample size of the unreplicated survey. Therefore, the Judges do not find sufficient basis to rely on the Sirius XM Survey.

B. Evaluation of Benchmark Evidence

1. The Subscription Benchmark/Ratio-Equivalency Models

A SoundExchange economic expert witness, Mr. Orszag, presents a benchmark analysis to estimate the statutory royalty rate to be paid by noninteractive subscription services. Orszag WDT ¶¶ 76-86. On behalf of Pandora, Professor Shapiro presents his benchmark analysis for this subscription royalty rate. Shapiro WDT at 39-40; *see also id.* at 30-38 (Professor Shapiro’s ad-supported benchmark analysis containing elements also applicable to his subscription benchmark analysis).

Mr. Orszag and Professor Shapiro each claims that his benchmarking model faithfully applies the Judges’ “ratio equivalency” benchmarking model applied in *Web IV*. Unsurprisingly, therefore, each of them criticizes the other’s model as failing to follow that *Web IV* model. The Judges first set forth the *essential* elements of Mr. Orszag’s adaptation of the *Web IV* “ratio equivalency” model and the criticisms of that approach. The Judges then engage in the same approach with regard to Professor

Shapiro’s model – identifying its *essential* elements – followed by Mr. Orszag’s critiques. The Judges then proceed to a more granular analysis of the dueling positions of these economists and set forth factual findings in these regards. Finally, the Judges set forth the benchmark rates that follow from their analysis and findings regarding the models proffered by these two experts.

a. Mr. Orszag’s Ratio-Equivalency Model

As noted above, Mr. Orszag engages in a benchmark analysis to estimate an appropriate statutory royalty to be paid to record companies by noninteractive services for subscription services. Orszag WDT ¶ 9. Mr. Orszag concludes that rates set in the *interactive subscription service* market are reasonable and appropriate benchmark rates, subject only to a downward adjustment to reflect the added value of interactivity in that proposed benchmark market. *Id.* ¶¶ 9, 11. By his approach, Mr. Orszag estimates a \$0.0033 per-play royalty rate for performances on subscription services. Orszag WDT ¶¶ 9, 86 & tbls.6,7. He proposes that the Judges adjust the rates to reflect annual changes in the Consumer Price Index, in a manner similar to the approach adopted in *Web IV*. Orszag WDT ¶ 8.

Mr. Orszag finds the subscription interactive market to be an appropriate benchmark for the target noninteractive subscription market because (1) the sellers/licensors (record companies) are identical; (2) the buyers/licensees, although not identical, are sufficiently similar; and (3) the right being sold/licensed is identical in both markets, *i.e.*, the right to play a sound recording. *Id.* ¶¶ 54-56.

In his benchmark comparison, Mr. Orszag avers that he is following the “ratio equivalency” approach undertaken by the Judges in *Web IV*. Orszag WDT ¶ 74. In *Web IV*, the Judges set forth the “ratio equivalency” formula as follows:

$$A/B = C/D$$

In this *Web IV* ratio equivalency approach:

[A] = Avg. Retail *Interactive* Subscription Price

[B] = *Interactive* Subscriber Royalty Rate

[C] = Avg. Retail *Noninteractive* Subscription Price

[D] = *Noninteractive* Subscriber Royalty Rate

Web IV, 81 FR at 26337-38.¹⁰⁷

However, Mr. Orszag does not define inputs [A], [B], and [C] as they had been identified in *Web IV*. Instead, he defines these four inputs as follows:

[A] = Total Benchmark Subscription Revenue

[B] = Total Benchmark Subscription Royalty Payments

[C] = Total Noninteractive Subscription Revenue

[D] = Noninteractive Subscriber Royalty Rate

8/11/20 Tr. 1224-1226 (Orszag).¹⁰⁸

Mr. Orszag testifies that he departs from the Judges' *Web IV* definitions of inputs [A], [B], and [C] for two reasons, neither of which, he asserts, contradicts the Judges'

¹⁰⁷ The "ratio equivalency" adopted by the Judges had been proffered by SoundExchange's economic expert witness, Professor Daniel Rubinfeld. *Web IV*, 81 Fed. Reg. at 26337. The Judges' reliance on Professor Rubinfeld's rationale for the use of the ratio equivalency approach is relevant in the present proceeding, as discussed *infra*.

¹⁰⁸ Input [C] is identified above as revenue from "noninteractive" services. However, Mr. Orszag used three mid-tier services with limited interactivity – Pandora, iHeart and Napster (Rhapsody) – as his proxies for statutory noninteractive services. Mr. Orszag's use of these proxy services creates a dispute separate from the overarching modeling dispute considered here, and that dispute is addressed *infra* when the Judges examine the more granular issues relating to these two benchmarking models. Also, note that item [D] in the *Web IV* formula and Mr. Orszag's model are identical because [D] is not a modeling input but rather the output generated by the formula (*i.e.*, the proposed statutory royalty rate).

rationale for using the “ratio equivalency” approach in *Web IV*. Quite the contrary, he testifies that these departures were *required*, in order to make the *Web IV* approach meaningful in the present proceeding. First, Mr. Orszag notes that in *Web IV*, the Judges used *per play* rates as input [B] because “none of the percentage-of-revenue prongs in the greater-of agreements in the record has been triggered, which may suggest that the parties to those agreements viewed the per-play rate as the rate term that would most likely apply for the length of the agreement.” *Web IV*, 81 FR at 26325. In other words, in *Web IV* the per-play rates *were* the effective rates.

Second, Mr. Orszag testifies that this *Web IV* factual basis for using a stated per-play rate is no longer applicable because royalty payments under current interactive agreements are predominantly made pursuant to “percentage of revenue” prongs” rather than per-play prongs, which are included “only occasionally” in current interactive agreements. Instead, according to Mr. Orszag, most current interactive agreements in the market instead contain a “greater of” rate formulation that includes a “per-subscriber” prong together with the “percent-of-revenue” prong. Orszag WDT ¶ 77.

As the value for his conception of [A], Mr. Orszag uses the gross revenues generated by Spotify from the performance of sound recordings from the three Majors and the Merlin-affiliated Indies over the most recent twelve-month period, April 2018 – March 2019. Orszag WDT ¶¶ 76, 83-84, 86, tbl.7.¹⁰⁹

¹⁰⁹ Mr. Orszag also analyzes data from Apple Music, Pandora, Amazon Music Unlimited, iHeart, Google, and Rhapsody, in addition to Spotify. He also obtains revenue data for the calendar year 2018. Orszag WDT tbls.6-7. However, he only uses the Spotify revenue data for the more recent of the two periods. Mr. Orszag also relies solely on Spotify royalty data from the same time period. Relying on the Spotify data for the most recent period ultimately yields [REDACTED] royalty rates in terms of percent-of-revenue and per-play rates [REDACTED] interactive services across each time period, *id.*, which is [REDACTED] for the noninteractive services within Mr. Orszag’s data set.

For his version of [B], Mr. Orszag uses the royalties paid by Spotify to the Majors and the Indies. Again, he selected Spotify data over the same period, April 2018 – March 2019, out of the seven total interactive services he considered. *See supra* note 109.

To identify a percent-of-revenue rate from inputs [A] and [B], Mr. Orszag calculates the reciprocal of $([A])/([B])$, which is the percent of revenue paid as royalties (*i.e.*, $([B])/([A])$). The A/B ratio of these data for Spotify over the relevant period is set forth below:

Revenues [A] = \$[REDACTED]

Royalties [B] = \$[REDACTED]

The $([A])/([B])$ ratio of the above figures equals [REDACTED]:1. Expressing this ratio factor as a reciprocal $([B])/([A])$ – thus expressing a percent of revenue royalty – results in a royalty rate calculation of [REDACTED]% (rounded). Orszag WDT ¶¶ 84-85 & tbl.7.¹¹⁰

In order to obtain a value for [C] in his model, Mr. Orszag selects Pandora, iHeart, and Rhapsody as his mid-tier proxies for the noninteractive service sector. Orszag WDT tbl.6. He testifies that he chose these three services because they had entered into direct licenses with record companies, thereby allowing him access to

Mr. Orszag states that he utilizes this lower royalty rate because he believes that [REDACTED] – a factor that weighs against any downward adjustment for the Majors’ complementary oligopoly market power. Orszag WDT ¶ 86. This market power issue is discussed at length elsewhere in this Determination.

¹¹⁰ In calculating the benchmark revenue and royalty totals (*i.e.*, [A] and [B]) Mr. Orszag excludes all plans which Spotify offered at discounts off full retail prices, *e.g.*, Spotify’s family, student, employee, and trial plans, as well as its promotional offerings. Orszag WDT ¶ 85 tbl.7. Pandora criticizes his decision to omit from his analysis the revenues, royalties and play counts generated by these discount plans, as discussed *infra*.

royalty statements containing reliable and necessary information. Orszag WDT ¶ 85 & tbl.7.

Having obtained values for [A], [B], and [C], Mr. Orszag can calculate a value for [D], his proposed statutory royalty rate for subscription services. He begins by multiplying the percent-of-revenue rate he derives from the left side of his model ([REDACTED]%) by the total revenues ([C]), \$[REDACTED], for his three noninteractive proxies. Orszag WDT ¶ 85 & tbl.7.

Despite computing a percent-of-revenue rate in the benchmark market SoundExchange does not propose a percent-of-revenue statutory royalty rate; rather, it proposes a per-play rate. According to Mr. Orszag, a per-play rate is preferable in order to avoid difficulties arising out of (1) defining revenue across business models; (2) separating out the sound recording revenue royalty base when music is bundled downstream with the sale of other items; and (3) accounting for a service's potential business practice of strategically lowering downstream prices. Orszag WDT ¶ 82. Accordingly, Mr. Orszag needs to apply his [REDACTED]% royalty percentage – derived from the left-hand/interactive benchmark market – so as to calculate a per play royalty rate for the right-hand/noninteractive target market.

To effect this conversion to a per play metric, Mr. Orszag divides the foregoing revenue figure by the number of plays on Pandora, iHeart, and Rhapsody over the relevant period (May 2018 – April 2019), which is [REDACTED] plays. The quotient of that division equals \$0.0033 per play, which is the value for [D] in Mr. Orszag's model and therefore his recommended per play rate for noninteractive subscription services. Orszag WDT ¶¶ 85-86 & tbl.7.¹¹¹

¹¹¹ Determining this per-play rate from the same Figure 7 data in another manner, Mr. Orszag notes that his three proxies for noninteractive subscription services had a combined average revenue per play of

**b. Pandora’s Criticisms of Mr. Orszag’s Application of the “Ratio
Equivalency” Model**

The Services claim that the “first and foremost error” in Mr. Orszag’s subscription benchmark analysis is his failure to correctly apply the *Web IV* “ratio equivalency model.” Shapiro WRT at 24-27. This alleged error supposedly begins with Mr. Orszag’s insertion of different inputs into that *Web IV* model.

More specifically, the Services point out that Mr. Orszag’s benchmark royalty input [B] is not a contractual per-performance royalty rate as in *Web IV* but rather the total royalties paid by his benchmark service, Spotify. 8/19/20 Tr. 2892-93 (Shapiro). Similarly, the Services note that Mr. Orszag did not use in the two numerators of his “ratio equivalency” formula (*i.e.*, [A] and [C]), respectively) the “average monthly retail subscription prices” that were used in the *Web IV* formulation of the model. Rather, Mr. Orszag substituted for [A] Spotify’s total subscription revenue and for [C] the total subscription revenue earned by Pandora, iHeart, and Rhapsody, his “mid-tier” (*i.e.*, limited interactive) proxies for a noninteractive subscription services. *See* Services PFFCL ¶ 163 (and record citations therein).

The Services take issue with Mr. Orszag’s method of solving for [D], total royalties to be paid. Again, Mr. Orszag multiplies his calculated [REDACTED]% interactive (benchmark) royalty rate by the total noninteractive revenue and (in the final step of his analysis) divides the total target [noninteractive] royalties [D] by the total plays on the three mid-tier services. *See* Services PFFCL ¶ 163 (citing Orszag WDT ¶ 85, tbls.6-7.)

\$(REDACTED) [\$(REDACTED) [REDACTED] divided by [REDACTED] billion plays) in the May 2018 – April 2019 period. Multiplying this average revenue per play by the [REDACTED]% royalty rate for interactive subscription services results in the per-play royalty of \$0.0033. Orszag WDT ¶ 85 & tbl.7.

According to the Services, the effect of Mr. Orszag's foregoing "ratio equivalency" approach is as follows:

[R]ather than charging the target statutory services the same per-play rate as the benchmark services [before any adjustments], as in *Web IV*, his model is set up to compute a rate where the target market services ... based on their prior revenues and play counts ... instead pay the same *percentage of revenue* as the benchmark services.

Services PFFCL ¶ 164 (citing Shapiro WRT at 25); 8/19/20 Tr. 2897 (Shapiro).

The Services criticize the foregoing approach by Mr. Orszag on several grounds. First, the Services find his modeling to be irreconcilable with the *Web IV Determination* in which, they claim, the Judges affirmatively rejected a percentage-of-revenue royalty metric for the statutory license. Services PFFCL ¶ 24 (*citing Web IV*, 81 FR at 26325-26).¹¹²

Second, the Services find Mr. Orszag's approach to be "unjustified" (as well as "roundabout" and "unnecessary") because SoundExchange is not actually advocating for a percent-of-revenue royalty but rather for a per-play rate. 8/19/20 Tr. 2893 (Shapiro); Shapiro WRT at 27-28. Alternately stated, the Services claim that because the royalty being set is a per-play royalty and not a percentage-of-revenue rate, *the appropriate starting point* for the benchmarking exercise is a per-play rate derived in the benchmark market and then subjected to any adjustments necessary to correct for potential

¹¹² To be clear, in *Web IV*, the Judges did not reject the use of "percent-of-revenue" royalties because they were legally or economically inappropriate. Rather, the Judges there expressly rejected SoundExchange's proposed "greater-of" rate proposal and chose to utilize only the per play rates within such benchmarks because *the evidence* demonstrated that "none of the percentage-of-revenue prongs in the greater-of agreements in the record has been triggered." *Web IV*, 81 Fed. Reg. at 26325. Thus, the Judges did not reject the concept of using a percent-of-revenue based royalty rate as a benchmark for noninteractive services for legal or economic reasons but rather for factual reasons particular to the *Web IV* record. Cf. *SDARS III*, 83 Fed. Reg. at 65221-22, 65229, and *Phonorecords III*, 84 Fed. Reg. at 1934 (both adopting percent-of-revenue royalty rates).

differences between the benchmark and target markets. Shapiro WRT at 24-25; Peterson WDT ¶¶ 13, 15.

As stated *supra*, before the Judges analyze Mr. Orszag's benchmark ratio equivalency approach and the objections thereto, they find it beneficial to next consider Professor Shapiro's benchmark ratio equivalency model and Mr. Orszag's objections thereto. Thereafter, the Judges can better compare and contrast these two benchmark models. The Judges proceed in that manner below.

c. Professor Shapiro's *Subscription* Model

Professor Shapiro also uses the interactive market as his benchmark, relying on direct licenses between eleven interactive services¹¹³ and the three Majors (Sony, Universal, and Warner). Shapiro WDT at 41; 8/19/20 Tr. 2826 (Shapiro). He compares the interactive benchmark market to the noninteractive target market by purporting to use the *Web IV* framework. More particularly, Professor Shapiro asserts that he is using the same definitions as used in *Web IV* for inputs [A], [B], and [C] in his "ratio" equivalency model in order to generate output [D] as a per-play rate.

By his approach, Professor Shapiro proposes that the statutory rate for subscription services fall within a range between \$[REDACTED] and \$[REDACTED] per play. He also proposes that the range should be indexed to for inflation, using 2019 as the base year (*i.e.*, the same year from which he obtained data), over the 2021-2025 rate period. Shapiro WDT at 2.

To compute a value for [A] in his ratio equivalency model, Professor Shapiro utilizes the same category of values as used by Professor Rubinfeld in *Web IV* – the monthly retail price for undiscounted subscription plans – which is \$9.99 per month.

¹¹³ The eleven interactive services are Amazon Prime, Amazon Unlimited, Apple, Deezer, Google Music, Napster, Pandora, Slacker, SoundCloud, Spotify, and Tidal. Shapiro WDT at 40 tbl.10.

8/19/20 Tr. 2828 (Shapiro) (“I’m following very closely what was done in *Web IV* by Professor Rubinfeld, actually, and then adopted by the Judges ... based on the ... retail prices for these plans, and that’s [\$]9.99”).

To calculate input [B], Professor Shapiro analyzes the most recent 12-month period for which data was available, May 2018 through April 2019. He calculates the average “effective” per-performance royalty rates paid by ten of the eleven services (weighted by each service’s percentage of total performances).¹¹⁴ The plays by the largest interactive services, [REDACTED] and [REDACTED], account for [REDACTED]% and [REDACTED]% of total plays, respectively, thus dominating the weighted average. Shapiro WDT at 40 tbl.10. Professor Shapiro then divides (i) the total royalties paid by the ten interactive services in his model¹¹⁵ by (ii) the number of interactive plays, to obtain a value for [B], \$[REDACTED], his effective per-play rate in the interactive benchmark market. *Id.*¹¹⁶

¹¹⁴ Professor Shapiro excludes [REDACTED] from the calculation “due to insufficient data,” but the exclusion has *de minimis* impact, he asserts, because [REDACTED] accounted for only [REDACTED]% of the 358.7 billion plays in Professor Shapiro’s benchmark grouping. Shapiro WDT at 40.

¹¹⁵ Unlike Mr. Orszag, Professor Shapiro calculates [B] (effective per-play rate) by utilizing the revenue and royalties generated by *all* interactive plans, including discounted interactive plans such as student, family and military plans, in addition to the revenue from undiscounted plans. And (because he is calculating an effective per-play rate in the benchmark interactive market), Professor Shapiro also incorporates into his calculation of [B] the number of interactive plays. 8/19/20 Tr. 2827 (Shapiro). By contrast, when calculating his value for [A], Professor Shapiro instead *uses only the full (undiscounted) retail price of an interactive service* rather than including in the value of [A] the retail price of *discounted* interactive plans. These issues are addressed in connection with the discussion of the more granular benchmark model issues, *infra*.

¹¹⁶ The total interactive royalties and interactive plays thus are inputs used to calculate the value of [B] in Professor Shapiro’s model rather than stated inputs in the ratio.

Professor Shapiro avers that *his* only departure from the *Web IV* approach is in his calculation of input [B], a departure born of necessity. Specifically, he notes that he could not use a per-play rate in the interactive benchmark market because (as Mr. Orszag also acknowledges) the majority of contracts between the Majors and the interactive services no longer contains a stated (headline) per-play prong. Thus, he had no alternative but to substitute an “effective” per-play rate as input [B]. Shapiro WDT at 41.

Of particular note here is a distinction between Professor Shapiro’s approach and that taken by Mr. Orszag because the latter *does not calculate a per-performance “effective” rate in the interactive benchmark market*. Rather, as discussed *supra*, Mr. Orszag calculates the “effective” *percent-of-revenue* paid as royalties in the benchmark interactive market ([REDACTED]%).

Claiming to continue to follow *Web IV*, Professor Shapiro next identifies the weighted average retail subscription price for the noninteractive proxies on the right-hand side of his ratio, \$4.99/month, as the value for [C], the numerator in the right-hand side of the “ratio equivalency” formula. Shapiro WDT tbl.9; 8/19/20 Tr. 2828 (Shapiro). Thus, having identified values for inputs [A], [B], and [C], his model solves for [D], including an implicit interactivity adjustment¹¹⁷ that is a function of the ratio equivalency formula. This value (before any further adjustments) is \$[REDACTED] per play.¹¹⁸

¹¹⁷ Note that Professor Shapiro also proposes an additional “second interactivity adjustment,” which the Judges address *infra* in their analysis of the details of Professor Shapiro’s ratio equivalency benchmarking model.

¹¹⁸ Professor Shapiro’s \$[REDACTED] per play (prior to adjustments other than an initial interactivity adjustment which is implicit in the model) is calculated as follows:

- (1) \$[REDACTED] divided by \$[REDACTED] equals \$[REDACTED] divided by [D]
- (2) cross-multiplying: \$[REDACTED] multiplied by [D] equals \$[REDACTED] multiplied by \$[REDACTED]

d. SoundExchange's Criticisms of Professor Shapiro's Benchmark

Model

As an initial matter, SoundExchange does not categorically reject Professor Shapiro's benchmarking approach. Rather, it asserts that identifying the effective per performance rate paid by the interactive services is not the "*necessary*" starting point for such an analysis. SX RPFCL (to Pandora/Sirius XM) at 67 (emphasis added). In a similar vein, SoundExchange asserts that "there is simply no reason why one *must* base the analysis on effective per-play rates in the benchmark market" SX PFFCL ¶ 111 (emphasis added).

Nonetheless, SoundExchange finds Professor Shapiro's application of the *Web IV* approach wanting. As an initial matter, SoundExchange disagrees with Professor Shapiro's understanding that the *Web IV* model should be applied so as to generate a per-play rate *in the benchmark (interactive) market*. Rather, SoundExchange argues that in *Web IV* the Judges required that the denominators [B] and [D] should reflect the *effective* royalty rate – *in whatever manner that royalty rate was established in the benchmark market* – so that the ratios [A]/[B] and [C]/[D] would be equivalent. And, the present record reflects that most of the interactive (benchmark) rates are set, as a matter of contract (that is to say, in the market), as a percent of revenue. (This is in contrast to the

(3) calculating the above step: \$[REDACTED] multiplied by [D] equals [REDACTED]

(4) dividing both sides by \$[REDACTED] solves for [D] equals \$[REDACTED] (rounded)

record in *Web IV* which revealed that, pursuant to marketplace contracts, the royalty rate was set on a *stated* per-play basis).¹¹⁹ Given this change in market reality, SoundExchange asserts that – for the ratios to be equivalent in the benchmark and target market – the ratio $[B]/[A]$ is the effective benchmark royalty rate. SX PFFCL ¶ 105 (citing 8/11/20 Tr. 1226 (Orszag) (“[B] over [A] representing the effective percentage of revenue royalty rate paid by the benchmark service”)).

According to SoundExchange, it is for the foregoing reason that Professor Shapiro should not have taken his intermediate step of deriving an effective per-play rate in the benchmark (interactive) market. Rather, according to SoundExchange, he should have solved for [D] (the statutory rate, by (1) applying the benchmark (interactive) percentage derived from the ratio $[B]/[A]$, (2) multiplying that percentage by [C], and (3) dividing that product by the number of noninteractive plays. Simply put, SoundExchange (unsurprisingly) asserts that, in order to follow the *Web IV* approach, Professor Shapiro needed to utilize Mr. Orszag’s approach.¹²⁰

**e. The Judges’ Analysis and Findings regarding the “Ratio
Equivalency” and Benchmarking Issues**

SoundExchange and Pandora accuse each other of misapplying the Judges’ ratio equivalency approach adopted in *Web IV*. However, the broadsides by each side miss the

¹¹⁹ SoundExchange also relies on statements in *Web IV* indicating that the Judges there were intending to set a per-play rate that effectively provided record companies with the same percentage of revenue in the target (noninteractive) market as in the benchmark (interactive) market. See SX RPFCL (to Pandora/Sirius XM) ¶ 189 (citing *Web IV*, 81 Fed. Reg. at 26326, 26338). The Judges discuss *infra* how those *Web IV* statements bear on the ratio equivalency issues raised in the present proceeding.

¹²⁰ As noted *supra*, this criticism relates *solely to the modeling aspects* of Professor Shapiro’s benchmark model. SoundExchange levels other criticisms at Professor Shapiro’s *application of his benchmark model*, which are discussed *infra*.

mark, as explained below. The parties' attacks are off-target because, in *Web IV*, the *effective* rates upon which the Judges relied *were also* the *stated* per-play rates in the benchmark (interactive) agreements.

Thus, Pandora is *incorrect* in arguing that Mr. Orszag misapplies *Web IV*. Rather, *consistent* with *Web IV*, he relies on and applies the royalty terms in the benchmark agreements which are based on a percent-of-revenue royalty prong within their greater-of rate formulae. Therefore, it is incorrect to say that Mr. Orszag acted in a manner inconsistent with *Web IV* by (1) using benchmark (interactive) total revenue as the metric for [A]; (2) using benchmark (interactive) total royalties for [B]; (3) calculating the reciprocal, [B]/[A], as the effective benchmark (interactive) percent-of-revenue royalty rate; and (4) applying that percent ([REDACTED]%) to the total revenue in the target (noninteractive) market.

But, neither has Professor Shapiro run afoul of *Web IV*. Consistent with *Web IV*, Professor Shapiro calculates an effective *per play* rate in the benchmark (interactive) market by applying the *actual* prong utilized in that market – the percent-of-revenue prong – and then identifies an [A]/[B] ratio to apply to the target (noninteractive) market. In *Web IV*, the Judges also explicitly identified a per-play rate as the appropriate rate to use for [B] and, as undertaken by Professor Shapiro, utilized the retail price for the benchmark (interactive) subscription as the value for [A].¹²¹

¹²¹ Moreover, as noted *supra*, SoundExchange does not reject Professor Shapiro's approach but rather asserts only that his starting point of identifying the effective performance rate paid by the interactive services is neither necessary nor mandatory. That is a far cry from an outright rejection. Further, the fact that such an approach might not be necessary or mandatory does not mean that it is inappropriate or without significant value.

But, then a puzzle presents: How can both approaches be both correct and thus incorrect? Are we faced with a paradox analogous to that of “Schrödinger’s Cat”?¹²²

The resolution of the paradox lies in two points: (1) when the Judges in *Web IV* extracted the ratio equivalency methodology out of the record evidence, they intentionally eliminated the linkage between per-play rates and percent-of-revenue rates in the “greater-of” rate formulae present in the benchmark interactive market agreements; and (2) in the present proceeding, benchmark (interactive) royalties are paid predominantly as a “percent-of-revenue,” whereas in *Web IV* they were paid on a per-play basis.¹²³ The Judges analyze below the impact of these two factors on the application of the benchmark models in the present proceeding.

i. De-Coupling of Contractual Per-Play and Percent-of Revenue Rates in *Web IV*

The contrasting attempts by Mr. Orszag and Professor Shapiro to follow the *Web IV* “ratio equivalency” faithfully derive from the particular factual and economic circumstances in *Web IV*. In that proceeding, SoundExchange had not proposed a *stand-alone* per-play rate. Rather, it had proposed that the Judges adopt a “greater-of” rate

¹²² “Schrödinger’s Cat” refers to a thought experiment regarding a theory of quantum mechanics involving a cat – sealed in a box with a flask of poison and a radioactive source – that, under the theory, conceptually may simultaneously be alive and dead. “Schrödinger’s Cat” has been extended in popular culture as a way to identify something as a paradox, unfeasible, or working against itself. *See* https://www.dictionary.com/e/tech-science/schrodingers-cat/?itm_source=parsely-api (last visited May 25, 2021).

¹²³ In fact, the record reflects that [REDACTED] and that [REDACTED]. 8/11/20 Tr. 1207-08 (Orszag); 8/20/20 Tr. 3000 (Shapiro). *See* SX PFFCL ¶ 112 (and record citations therein).

Although the Services do not acknowledge such a sweeping abandonment of stated per-play rates, Professor Shapiro recognizes that “[REDACTED].” Shapiro WDT at 39.

structure, in which the statutory subscription royalty rate would be the greater of (1) \$0.0025 per play and (2) 55% of service revenue. *Web IV*, 81 FR at 26335. In support of that structure, SoundExchange, through its economic expert, Professor Daniel Rubinfeld, asserted, *inter alia*, that (1) “the per-play prong provides a guaranteed revenue stream” and (2) “the percentage-of-revenue prong allows record companies to share in any substantial returns generated by a Service.” *Web IV*, 81 FR at 26324. Thus, SoundExchange proposed the per-play rate – not as a *stand-alone value*, but rather as a *partial metric* – one that it believed served as a “guarantee” – a floor on the percent-of-revenue effectively paid as royalties.¹²⁴

As noted *supra*, in *Web IV* the Judges rejected the “greater-of” structure and adopted a per-play rate structure. But, their decision was not unrelated to the valuation of the royalty payments as a function of revenue. Rather, the Judges adopted the per-play rate approach in reliance upon Professor Rubinfeld’s testimony that his “ratio equivalency” methodology resulted in a per-play royalty payment (\$0.0025) that approximated 55% of service revenue, which, as noted above, was SoundExchange’s percent-of-revenue royalty proposal. *Web IV*, 81 FR at 26324 n.44, 26326. Thus, in *Web IV* the Judges understood that the per-play rate was not proposed as a purely independent measure of the value of an individual play, but rather as a metric that was also designed to approximate a minimum royalty rate of 55% of revenue.

Importantly, when the Judges in *Web IV* de-coupled the percent-of-revenue and per-play rates, rejecting the former approach and adopting the latter, the Judges also eliminated the capacity of the per-play rate to serve its limited function as a form of

¹²⁴ Professor Rubinfeld apparently relied on per-play royalties as input [B] in his “ratio equivalency” approach because the per-play prongs were the ones triggered in the market and his intention was to faithfully utilize actual market data.

“guarantee.” Thus, the royalty rate paid by noninteractive subscription services during the *Web IV* 2016-2020 rate period – as adjusted (for other reasons) by the Judges from \$0.0025 to \$0.0022 for 2016 – did not correspond with any particular percent-of-revenue floor. Rather, the effective percent-of-revenue paid as a royalty would vary with the level of noninteractive service *revenue* and quantity of plays.¹²⁵

With *Web IV* having severed the link between percent-of-revenue and per-play rates, the attempts *in this proceeding* by Mr. Orszag and Professor Shapiro to adopt the *Web IV* ratio equivalency approach – in order to set a per-play rate derived from a percent-of-revenue rates – are problematic because, as in *Web IV*, the per-play rate is untethered to a percent-of-revenue rate. Indeed, despite their best efforts, neither Mr. Orszag nor Professor Shapiro could synthesize what *Web IV* had (for good reason) torn asunder.

**ii. In the Benchmark (Interactive) Market, Per-Play Rates Were Paid
in the *Web IV* Era; but in the *Web V* Era Percent-of Revenue
Rates are Now Paid**

Whereas in *Web IV* the actual rate in the benchmark (interactive) market and the proposed target statutory rate were both per-play rates, in this *Web V* proceeding the actual benchmark rate is now most often a percent-of-revenue rate. Despite this important change in the benchmark (interactive) market, the parties agree that the statutory rate should remain a per-play rate.

Accordingly, the parties’ criticisms not only miss the mark, they fail to illuminate the issue at hand. The Judges need to revisit the economic principles identified in *Web IV*

¹²⁵ By contrast, if the Judges had adopted only a percent-of-revenue structure, the royalty paid by a noninteractive service obviously would have remained at that fixed percentage.

that undergird the ratio equivalency approach in order to apply that formula to the present record.

The concept of ratio equivalency is based on the principle that record companies, as licensors, in a hypothetical unregulated world “would want to make sure that the marginal return that they could get in each sector [interactive and noninteractive] would be equal, because if the marginal return was greater in the interactive space than the noninteractive ... you would want to continue to pour resources, recordings in this case, into the [interactive] space until that marginal return was equivalent to the return in the noninteractive space.” *Web IV* 81 FR at 26344. This is an example of “a fundamental economic process of profit maximization,” *id.*, one that “pervades much of [e]conomics: A rational seller or licensor will “[a]llocate resources among alternative uses so as to keep the marginal returns equal, or as near equal as possible [because] if marginal products aren’t equal, there’s a gain to be had by reallocating some resources from the use with the lower marginal product and assigning them where the marginal product is higher.” ARMEN A. ALCHIAN & WILLIAM R. ALLEN, *UNIVERSAL ECONOMICS* at 102 (2018) (summarizing this principle as “the equalization of marginals at the maximum aggregate return”). In the present case, this economic logic implies that rational profit-maximizing record companies will seek to earn the same return for each relevant “unit” of value across both the interactive and noninteractive markets.

In *Web IV*, the *metric* for the royalty rate was per play, *i.e.*, each individual performance of a copy of a sound recording. However, downstream *revenue* is not generated on a per-play basis. Rather, in the case of streaming subscriptions, marginal

revenue can be generated by incremental increases in the number of subscriptions.¹²⁶ A record company would seek to avoid a scenario where it loses marginal royalty revenue on each subscription dollar if listeners who would otherwise have chosen to become interactive subscribers instead decide to become noninteractive subscribers. By equalizing the percent of revenue paid as royalties per subscription dollar, the rational record company is indifferent regarding to which of these two forms of music services a consumer decides to subscribe.¹²⁷ (And, it should also be noted, on the *cost* (supply) side, a particular feature of *copies* of sound recordings is that their transmission does not generate a marginal physical production cost. *See Phonorecords III Dissent*, 84 FR at 1976 (and citations therein)).¹²⁸

This is the precise point on which Professor Rubinfeld relied and as to which the Judges in *Web IV* agreed. Thus, the actual economic concern in *Web IV* was setting rates based on a per-play rate that was a marketplace proxy for a minimum percent-of-revenue earned by an assumed substitute service, *i.e.*, interactive services (approximately 55%), which generates marginal opportunity costs.¹²⁹

In the present case, SoundExchange makes this point repeatedly, citing to language in the *Web IV* Determination. *See, e.g., id.* at 26338 (“[G]iven Dr. Rubinfeld’s

¹²⁶ Services could also hypothetically increase marginal revenue simply by raising subscription prices. There is no evidence in the record, though, indicating that services have the market power to increase subscription prices charged within various segments of the retail market.

¹²⁷ Of course, concern for substitution is appropriate only if the two services are indeed substitutes among consumers. This important point is considered *infra*.

¹²⁸ The *Phonorecords III* majority Determination does not conflict with this economic point.

¹²⁹ To be clear, that concern is not the end of the story. Potential adjustments also need to be considered to reflect effective competition, differences in WTP for substitutes (for example, because of interactivity differences), and inconsistent definitions of a “play” between service types (the “skips” issue).

assumption that the ratios should be equal in both markets, the per-play royalty rate for noninteractive services [*D*] (*i.e.*, the statutory rate) would also have to provide record companies with *the same minimum percentage of revenue out of [C] (the average monthly retail noninteractive subscription price).*”) (emphasis added); *id.* at 26344 (“Dr. Rubinfeld acknowledged that his ‘ratio equivalency’ was intended to *create a rate whereby every marginal increase in subscription revenue would result in the same increase in royalty revenue*, whether that marginal increase in subscription occurred in the interactive market or the noninteractive market.”) (emphasis added); *id.* at 26324 n.44 (noting that Dr. Rubinfeld’s ratio equivalency per-play methodology resulted in an interactive royalty payment generally ranging from 50% to 60% of subscription revenues, with most falling between 55% and 60%); *id.* at 26338 (the per-play rates relied upon by Dr. Rubinfeld implied these same express percent-of-revenue rates as set forth in the “greater-of” formulae in the interactive direct licenses). To buttress this point, SoundExchange notes that the Judges’ restatement in *SDARS III* of the “ratio equivalency” model is consistent with the understanding that this approach is intended to equalize royalties as a percent of revenue. SX PFFCL 119 (citing *SDARS III*, 83 FR at 65243 n.137).

The Judges agree with SoundExchange’s assertion in this regard. Accordingly, the Judges find that the *Web IV* “ratio equivalency” approach was properly intended to approximate and equalize percent-of-revenue royalties for interactive and noninteractive subscriptions – on the assumption that interactive and noninteractive subscriptions were 1:1 substitute products for consumers downstream. If and when such substitution exists, Mr. Orszag’s “ratio equivalency” approach is the more appropriate methodology.

Nonetheless, based on the record in this proceeding, the Judges do not find good reason to apply Mr. Orszag’s benchmark rate other than in a partial manner. That is, because the “ratio equivalency” approach is economically premised on a presumed high

substitutability (cross-elasticity in economic parlance) between interactive and noninteractive subscriptions, this equivalency cannot be economically pertinent where, as here, the record presents the Judges with facts in conflict with that presumption.

Again, recall that in *Web IV*, the Judges stated: “Dr. Rubinfeld’s ‘ratio equivalency’ *assumes a 1:1 ‘opportunity cost’* for record companies, whereby, on the margin, a dollar of revenue spent on a subscription to a noninteractive service is a lost opportunity for royalties from a dollar to be spent on a subscription to an interactive service.” *Web IV*, 81 FR at 26344-45 (emphasis added). To make clear that the *Web IV* Judges found this 1:1 substitutability to be a presumption (and certainly not an axiom), they rejected SoundExchange’s attempt to extend this 1:1 substitution argument to the ad-supported market in order to equalize royalties as a percent of revenues in that market with the percent applicable in the subscription interactive market. In rejecting this attempted extension of the 1:1 substitutability presumption, the Judges took note of a sharp dichotomy in the willingness to pay (WTP) of listeners in each market. *Web IV*, 81 FR at 26345-46, 26353.

However, the Judges did apply a 1:1 substitutability of subscription interactive services for subscription noninteractive services in *Web IV* and noted its limited application:

Dr. Rubinfeld’s interactive benchmark is only applicable when, *inter alia*:

Revenues in both markets are *derived from subscription revenues and are thus reflective of buyers with a positive WTP* for streamed music; [and] functional convergence and downstream competition for potential listeners indicate *a sufficiently high cross-elasticity of demand as between interactive and noninteractive services*, provided the noninteractive subscription rate is reduced to reflect the absence of the added value of interactivity

Web IV, 81 FR at 26353 (emphasis added). Applying these principles, *Web IV* held:

When the segment of the market at issue consists of willing buyers/licensees who are providing access through subscription-based listening to listeners who have a WTP for either interactive or noninteractive services that are close substitutes, then Dr. Rubinfeld’s “ratio equivalency” is reasonably based on revenues.

Web IV, 81 FR at 26348 (emphasis added).

These quoted portions of *Web IV* show that the Judges dichotomized between Dr. Rubinfeld's use of the "ratio equivalency" model by rejecting it for the ad-supported noninteractive services but applying it to subscription noninteractive services. But these quoted portions also demonstrate that the Judges applied a "ratio equivalency" across the benchmark and target subscription markets by *presuming* that *subscribers'* revealed positive WTP for both interactive and noninteractive services was sufficient to show the necessary cross-elasticity and, relatedly, that each product was a close substitute for the other (after making an adjustment for interactivity).¹³⁰

In the present proceeding, a consumer survey in evidence, commissioned by SoundExchange – the Zauberman Survey – provides relevant information regarding the question of whether and to what extent subscription *interactive* services are substitutes for subscription *noninteractive* services. As analyzed and applied by one of SoundExchange's other economic expert witnesses, Professor Willig, the Zauberman Survey indicates that only 11.5% of subscribers to noninteractive services would divert to listening to subscription interactive services if their noninteractive subscription service were no longer available. *See* Willig WDT ¶ 47 fig.6.¹³¹ These survey results indicate

¹³⁰ Such an assumption was not unreasonable as there were no "opportunity cost" surveys such as in the present case indicating the extent of cross-elasticity or substitutability of interactive and noninteractive subscriptions. As discussed, *infra*, that evidentiary absence does not exist in the present proceeding. Also, in *Web IV*, the \$0.0025 benchmark (adjusted to \$0.0022) that presumed this 1:1 substitutability was consistent with Pandora's own proposed benchmark derived from its *noninteractive* market agreement with [REDACTED]. *Web IV*, 81 Fed. Reg. at 26405.

¹³¹ The Hanssens Survey indicates, according to Professor Shapiro, that this diversion to new interactive subscriptions would be even smaller, measuring [REDACTED]%. Shapiro WDT at 28 tbl.5. This lower figure would not alter the weights assigned to the benchmarking and ratio-equivalency models.

there is far less than the 1:1 substitution ratio between subscription *interactive* services and subscription *noninteractive* services that was *presumed* in *Web IV*. This SoundExchange-proffered evidence indicates that Mr. Orszag's per-play rate – derived from his ratio equivalency approach – has only limited applicability.

Moreover, in *Web IV* and also in *SDARS III*, the Judges laid out this precise critique of a ratio equivalency approach proffered by Mr. Orszag, with the Judges also relying on survey evidence to make the point:

The survey results highlight a ... criticism ... of Mr. Orszag's ratio equivalency approaches. ... [T]he economic rationale support[ing] a ratio equivalency approach requires 'significant competition, or a high cross-elasticity of demand, between [the target market] and [the benchmark market] [A] limited degree of head-to-head competition ... will not suffice....' Web IV, 81 FR at 26353

In *Web IV*, the Judges stated that the ratio equivalency approach might be appropriate if the record reflected ... *a sufficiently high cross-elasticity of demand as between interactive and noninteractive services*, provided the noninteractive subscription rate is reduced to reflect the absence of the added value of interactivity.... 81 FR at 26353.

In the present case, Mr. Orszag did not provide either qualitative or quantitative evidence of a sufficiently high cross-elasticity.... [T]he survey results reported by SoundExchange's own survey witnesses ... indicated that there is no such high substitutability between subscribership to interactive services and [the target market.] *These survey conclusions negate any complete or overwhelming ratio equivalency Mr. Orszag has posited.*

SDARS III, 83 FR at 65247 (emphasis added).¹³²

¹³² The Judges are perplexed by SoundExchange's decision to propose a per-play rate as opposed to a percent-of-revenue rate. Mr. Orszag could have more simply applied his [REDACTED]% percent-of-revenue rate as the applicable benchmark rate (subject to any warranted adjustments). Further, the Judges note that the Majors and the services revealed their [REDACTED] in the interactive market – *a market that is unregulated and [REDACTED] to the record companies than the noninteractive market. Compare Orszag WDT tbl.4 (2018 U.S. interactive subscription revenue was \$[REDACTED]) with id. tbl.6 (2018 U.S. subscription revenue for Mr. Orszag's noninteractive proxies (including Pandora) was \$[REDACTED], [REDACTED]% of the interactive revenue). There is no reason provided in the record to*

iii. The Judges' Application of Mr. Orszag's and Professor Shapiro's Models

In sum, Professor Shapiro's model is more of a traditional benchmarking model. He identifies the interactive market as similar in terms of licensors, licensees, and licensed works, and he proposes adjustments (discussed *infra*) that allegedly correct for differences between the otherwise analogous benchmark and target markets. On the other hand, Mr. Orszag's approach is essentially an "opportunity cost" model more than it is a traditional "benchmark model." Because SoundExchange's survey evidence, as applied by Professor Willig, reveals the limited applicability of the opportunity cost approach, the model cannot be extended to the entire market.

Therefore, the Judges find it necessary to apportion the applications of Professor Shapiro's benchmark result and Mr. Orszag's benchmark result. The Judges find it reasonable to apportion 11.5% of Mr. Orszag's proposed benchmark rate toward the subscription benchmark rate.¹³³ The Judges apply the remaining and greater weight, 88.5% (*i.e.*, 1-.115), to the more traditional benchmark approach undertaken by Professor

explain why SoundExchange and Mr. Orszag would find practical issues relating to revenue definition – which were insufficient to reject a percent-of-revenue rate in the far larger and unregulated interactive market – to be so vexing in the noninteractive market as to necessitate the conversion of the benchmark percent-of-royalty rate into a statutory per-play rate.

¹³³ The Judges prefer Mr. Orszag's approach over Professor Shapiro's approach for the portion of the market in which the relevant cross-elasticity/substitutability is high. As the Judges noted in *SDARS III*, *if and when the opportunity cost approach is appropriate*, it can be superior to a benchmark approach in estimating the statutory rate. *SDARS III*, 81 Fed. Reg. at 65231 (“*When properly weighted*, the opportunity cost approach is tantamount to a useful benchmark, because the weightings are quite analogous to (and more precise than) the ‘adjustments’ the Judges consistently make to proposed benchmarks.”) (emphasis added).

Shapiro that relies on the broad similarities in terms of rights, licensors, and licensees, without adding assumptions regarding substitution patterns between the target noninteractive subscription market and the benchmark interactive subscription market.

The Judges will apply these apportionments to each expert's proposed rate *after* the Judges consider the more granular criticisms of each expert's approach and the proposed adjustments to those rates.

iv. The Parties' Granular Criticisms of their Adversary's

Subscription Benchmarking

Having resolved the differences between Mr. Orszag and Professor Shapiro regarding the *overarching issue* of how to apply ratio equivalency and benchmarking principles, the Judges now turn to the *detailed* critiques of each approach.

(A) SoundExchange's Granular Criticisms of Professor Shapiro's

Benchmarking and the Judges' Analysis and Findings regarding those Criticisms

(1) Professor Shapiro's Inclusion of Discount Plan Royalties and Play Counts in Calculating a Value for [B], the Effective Per-Play Royalty in the Benchmark (Interactive) Market

SoundExchange criticizes Professor Shapiro for including the royalties and play counts associated with interactive services' *discount plans* in order to calculate the value of [B] in his benchmarking model. More precisely, Professor Shapiro calculates an effective interactive (benchmark) per-play royalty rate [B] by including in his numerator the total royalties paid and, in his denominator, the play counts – *not only for the interactive services' full-price (\$9.99) subscription plans but also for discount plans, such as student, family, and military plans.* 8/19/20 Tr. 2931 (Shapiro); Shapiro WDT, app. D.1.B n.7.

According to Mr. Orszag, this has the effect of lowering the effective per-play rates in the benchmark market and therefore the proposed rates for the target market. To make this point, he compares his calculation of the weighted average subscription per-play rate *excluding* discount plans—\$[REDACTED] per play—with Professor Shapiro’s effective per-play rate for the same services *including* discount plans—\$[REDACTED] per play. Trial Ex. 5603 ¶ 88 (WRT of Jon Orszag) (Orszag WRT).

In response, Professor Shapiro asserts that it would be inappropriate to hand-pick a subset of the market (*i.e.*, just the full-price plans) in order to generate the per-play rate because the statutory rate will apply to royalties generated by all subscribers regardless of whether they subscribe to a full-price or discounted plan. 8/19/20 Tr. 2852-53, 2898-99 (Shapiro).

The Judges agree with Professor Shapiro that the identification of a per-play benchmark rate in his model for subscription services should be based on the royalties and play counts of all plans. There is no valid reason to cherry-pick among the plans when calculating this benchmark input because all noninteractive services offering subscription plans will pay the calculated per-play royalty across all plans, whether full price or discounted.¹³⁴

¹³⁴ Mr. Orszag claims that interactive discount plans should be ignored because [REDACTED] engages in much less discounting. He claims that this difference requires the Judges to look only at full-price plans in order to make an “apple-to-apples” comparison. SX RPFCL (to Pandora/Sirius XM) ¶ 186 (citing 8/11/20 Tr. 1215 (Orszag)). But, Pandora analogizes to another food group (characterizing *this* point as a “red herring”), namely one that is unresponsive to the need to consider that all noninteractive subscription services will pay the statutory per play rate, regardless of whether they engage in discounting. Pandora/Sirius XM PFFCL ¶186 (citing 8/19/20 Tr. 2852-53 (Shapiro)). The Judges disagree with SoundExchange’s reliance on the different degrees of discounting. Discount plans are forms of price discrimination, designed to increase overall revenue. There is no reason why the manner in which different

(2) Professor Shapiro's Use of Full Subscription Prices rather than Average Revenue per User (ARPU) for the Values of [A] and [C]

SoundExchange also criticizes Professor Shapiro's inputs for the values for [A] and [C] in his benchmarking model, which represent the monthly downstream retail price of the interactive benchmark subscriptions and the proxies for the noninteractive services, respectively. 8/19/20 Tr. 2936-37 (Shapiro). SoundExchange asserts that Professor Shapiro should have used the Average Revenue per User (ARPU) for these values (which would have incorporated any lower discounted retail prices) rather than the full retail subscription prices for [A] and [C], which were \$9.99 and \$4.99, respectively. *For the first time in this proceeding*, at the hearing, SoundExchange, through Mr. Orszag, sought to raise a concern that Professor Shapiro's use of retail prices rather than ARPU for [A] and [C] is improper. He maintained that because Professor Shapiro used all plans, including discounted plans, to calculate the effective per-play rate ([B]), as described above, while neglecting the discount plans' ARPU when providing values for [A] and [C], Professor Shapiro's model "[REDACTED]." 8/11/20 Tr. 1387-88 (Orszag).¹³⁵ In Mr. Orszag's opinion, because Professor Shapiro calculates effective per-play royalty rates in a manner that includes all plans (including discount plans), he likewise should have based the interactivity adjustment on the effective payment for all plans, including discount plans. 8/10/20 Tr. 1164-67 (Orszag).

services generate revenue should affect the calculation of per play rates in this benchmarking exercise, unless the Judges were asked by the parties to consider setting different royalty rates for full-price and discount subscription plans (which no party has requested).

¹³⁵ As noted *supra*, the first of Professor Shapiro's proposed two-part interactivity adjustment is implicit in the ratio equivalency approach and, for presentation purposes, is more naturally considered as an element of the modeling rather than as a stand-alone adjustment.

Further to this argument, SoundExchange notes that Professor Shapiro acknowledges that identifying what customers actually pay on a per-subscriber basis is preferable to relying on an undiscounted price that is paid by many, but not all, of the subscribers. SX PFFCL ¶ 136 (citing 8/19/20 Tr. 2939 (Shapiro)). In addition, SoundExchange explains that, although the use of discount plans is a form of price discrimination, Professor Shapiro concededly did not build this price [REDACTED] only on the full prices for subscriptions as his values for [A] and [C]. SX PFFCL ¶ 137 (citing 8/19/20 Tr. 2958-59 (Shapiro)).

SoundExchange then uses its post-hearing PFFCL submissions to set forth its proposed new analysis, in which it suggests several different potential ARPU levels that could be used to substitute for [A], the retail price paid in the benchmark interactive market. *See* SX PFFCL ¶¶ 139-140 (and references cited therein).

However, the Services emphasize that none of SoundExchange's witnesses raised an objection in their written rebuttal testimonies to Professor Shapiro's use of retail prices as the metric for [A] and [C] in any of the witnesses. The Services further aver that no witness at the hearing proffered alternative ARPU calculations for use as values for [A] and [C]. *See* Pandora/Sirius XM PFFCL ¶ 191. Moreover, the Services note that this issue has already been resolved at the hearing, when a proffer by SoundExchange of testimony from Mr. Orszag was met with a motion by the Services to bar such testimony. At the hearing, after extended argument and colloquy, 8/25/20 Tr. 3821-28 (argument and colloquy), the Judges sustained the Services' objections to the presentation by Mr. Orszag of his belated attempt to raise this issue and attempt to utilize ARPU data for the first time from the witness stand in an attempt to support that new analysis because such 11th-hour testimony and data review would constitute delinquent and thus improper "new analysis." 8/25/20 Tr. 3821-28 (Chief Judge Feder) ("[T]his is a new analysis. The objection is sustained.").

Moreover, the Services note that contrary rebuttal arguments were certainly available for them to raise, if SoundExchange had advanced this assertion in a timely fashion. First, they take note that there is no established manner by which the industry calculates ARPU for discount plans. As Professor Shapiro and Mr. Orszag both testify, there is no uniform method employed by the various services for making that calculation, and SoundExchange has provided no evidence to the contrary. 8/19/20 Tr. 2943-44 (Shapiro); 8/11/20 Tr. 1199-1200 (Orszag) (conceding that “there are some differences between how [the Majors]” account for family plans in their ARPU calculations). Second, they note that the several discount-based ARPU ratios [A]:[C] suggested by SoundExchange as supporting Mr. Orszag’s unadmitted “new analysis” are themselves contradicted by the ARPU-based ratio for Pandora’s own interactive “Premium” service and its Pandora Plus service. 8/19/20 Tr. 2853-54, 2855-56 (Shapiro).

Additionally, Professor Shapiro opines that his reliance on the ratios of full price retail subscriptions to effective per-play rates is a cleaner method to isolate the value of interactivity, and an inclusion of discount plans would inject confounding issues relating to the bundling of use by family plan members. 8/26/20 Tr. 3932 (Shapiro) (distinguishing (1) his use of royalties and plays from all plans as identifying an effective per-play rate to cover all plays from all plans from (2) the attempt to measure the “value of interactivity, that’s \$9.99 versus \$4.99, nicely isolated for particular individual undiscounted plans”); *see also* Pandora/Sirius XM PFFCL ¶ 190.

The Judges find that SoundExchange cannot resurrect this belated argument in its post-hearing submissions, through counsel, after the Judges had already ruled that the issue had been delinquent when presented for the first time at the hearing. Moreover, SoundExchange has not presented any argument in its post-hearing submissions to suggest that the Judges should revisit their decision. Indeed, the dispositive effect of SoundExchange’s delinquency in making this argument remains manifest; having had no

timely and proper notice of this argument, the Services and their witnesses had no ability to prepare a contrary argument.

Additionally, as the Judges note *supra*, the Services have identified specific rejoinders to Mr. Orszag's "new analysis," which could not be explored thoroughly because SoundExchange did not raise this issue in a timely manner. Further, the Judges note that Professor Shapiro's reliance on the use of undiscounted retail prices as his values for [A] and [C] was consistent with the Judges' formulation of the ratio equivalency approach in *Web IV*.

For these reasons, the Judges do not give any weight to SoundExchange's arguments in this regard.¹³⁶

(3) Professor Shapiro's Generation of a Per-Play Rate in the Benchmark Market

SoundExchange also asserts that Professor Shapiro's generation of an effective per-play rate in the benchmark interactive market "is inconsistent with market reality." SX PFFCL ¶ 112. This is an odd critique, in that Mr. Orszag and SoundExchange are themselves proposing a per-play rate structure, the very approach it claims to be at odds with "market reality." *See* Services RPFCL ¶ 112 ("If the ... shift from interactive services paying under per-play metric to a percentage-of-revenue metric really had ... market-wide relevance ... one would have expected [Mr. Orszag] to propose a percentage-of-revenue rate for statutory purposes."). Further, because both SoundExchange and Pandora propose a per-play rate generated from a non-per-play benchmark, a conversion to a per-play rate must occur *at some point in the analysis*, and

¹³⁶ To be clear, the Judges are not making any substantive finding regarding how they would rule if a timely argument were to be made in a subsequent proceeding regarding the merits of using ARPU values for numerators [A] and/or [C].

SoundExchange does not adequately explain why making this conversion in the benchmark market (early in the analysis) is any more in accord with “market reality” than engaging in the conversion in the target noninteractive market as a final step. Indeed, as noted at the outset of the Judges’ presentation of SoundExchange’s critique of Professor Shapiro’s benchmark, they explicitly assert only that his setting of a per-play rate in the benchmark market is neither necessary nor mandatory—not that it was improper. *See supra*, section IV.B.1.d.

**(B) The Services’ Criticisms of Mr. Orszag’s Benchmarking and
the Judges’ Analysis and Findings regarding those Criticisms**

(1) SoundExchange’s Reliance on Pandora’s Data

The Services criticize Mr. Orszag for relying only on Pandora’s revenue and play counts in his ratio equivalency approach. Services PFFCL ¶ 29 (and record citations therein). However, SoundExchange responds by noting that Pandora Plus has an [REDACTED]%+ market share, making it a highly suitable data source. Further to this point, SoundExchange notes that, when appropriate, the Judges have relied in past proceedings on facts and data attributable to entities with significant market share. SX RPPFCL (to Services) ¶ 29.

The Judges find the Services’ criticism to be without merit. Mr. Orszag acted reasonably and in a manner consistent with the Judges’ past reliance upon data from a significant industry participant. Moreover, as the Judges have said on several other occasions, the statutory rate- setting process does not instruct the Judges to protect any particular business model. Thus, Mr. Orszag’s decision to rely on data from the largest noninteractive service with arguably the most successful business model (in terms of market share) can hardly be considered improper.

**(2) Mr. Orszag's Model will not Generate a Royalty Equal to
[REDACTED]% of Revenue Across Noninteractive
Services**

The Services also object to Mr. Orszag's approach because his model's per-play royalty rate will not equate with [REDACTED]% of any noninteractive service's revenue (including Pandora) unless, by coincidence, it has revenues and a play count that generate that effective percentage royalty level. Accordingly, the Services maintain that Mr. Orszag's approach cannot even generate its "foundational premise" of "ratio equivalency," whereby noninteractive services pay the same percentage of revenue rate as paid by interactive services in the benchmark market. Shapiro WRT at 28; 8/19/20 Tr. 2893-95 (Shapiro). Relatedly, the Services claim that Mr. Orszag fails to identify revenue and play counts for any existing statutory service, and for this reason as well he thus had not analyzed whether any such service would in fact pay [REDACTED]% of its revenues in royalties if it paid \$0.0033 per performance. Services PFFCL ¶ 174.

The first criticism is correct but uninformative. It is but a specific example of a more general criticism: Any rate or rate structure set by the Judges can (and likely will) affect different regulated entities somewhat differently and also be rendered inaccurate or obsolete during the five-year rate term by changes in the marketplace. This is closely analogous to the well-known concept of "regulatory lag" in public utility regulation. *See* ALFRED E. KAHN, 1 THE ECONOMICS OF REGULATION 54 (1970) ("regulatory lag" results from the fixing of a rate for a period of time and the inability of regulated companies to maintain rates of return that were deemed satisfactory at the inception of the rate period").

The second criticism is also off-target. As SoundExchange states by way of response, Pandora's subscription service indeed would pay essentially [REDACTED]% of its revenue as royalties pursuant to Mr. Orszag's proposed per-play rate (because

[REDACTED]), and Mr. Orszag multiplied his proxy revenues by his [REDACTED]% benchmark royalty rate and then divided by the number of noninteractive proxy plays) SX RPFCL (to Services) ¶ 174. While it is true that Pandora Plus is not a statutory service, the parties (including Pandora) have used it as a proxy for such services in this proceeding, subject to adjustments for, *inter alia*, differences in interactivity, if appropriate.¹³⁷ Thus, the appropriate response by the Services is not to urge the Judges to reject outright this proxy-based analysis, but rather to: (1) propose proper adjustments that would purportedly align the benchmark proxies to the statutory market; and/or (2) propose alternative benchmarks (which the Services have done).

(3) Mr. Orszag Fails to Identify a Per-Play Rate that Adequately Captures the Value of Individual Plays

Next, the Services assert that Mr. Orszag's reliance on a percent-of-revenue centric benchmarking approach fails to adequately capture a value attributable to each play of the sound recording, which is the metric he proposes. Shapiro WDT ¶ 47. The Judges reject this criticism. A fundamental rationale for Mr. Orszag's modeling approach, as the Judges discussed above, is that the value to be generated in this market for "second copies" of sound recordings lies not in the recordings of songs whose

¹³⁷ Further, if the Services wanted to avoid a per play rate that would generate different effective percent-of-revenue royalty rates for different entities, it could have proposed a percent-of-revenue rate, either in its direct case or as a rebuttal to Mr. Orszag's benchmark per play rate proposal. Instead, the Services, like SoundExchange, propose only a per-play rate, that will also necessarily generate different effective percent-of-revenue royalty rates for different noninteractive services, depending upon their revenues and play counts. Also, as discussed *infra* with regard to Professor Shapiro's proposed additional (second) interactivity adjustment, the record evidence does not demonstrate that the Pandora Plus mid-tier service, priced at \$4.99, is more valuable downstream than a statutorily-compliant noninteractive service, making Mr. Orszag's use of mid-tier services, Pandora Plus, iHeart and Napster (Rhapsody), as proxies for revenue and play count-purposes a reasonable modeling choice. See Orszag WDT ¶¶ 176-179.

marginal (non-opportunity) cost is zero and whose marginal revenue is non-existent (because listeners do not pay per song as with a juke box), but rather in the revenue derived from subscribers (and advertisers in the ad-supported market). Thus, there is no economic “value” inherent in the “second copies” of the sound recordings from a marginalist perspective. Of course, there is tremendous value in the sound recordings themselves, in terms of the costs of artist discovery, development, recording and promotion, and – not to be deemphasized – the entrepreneurial profit generated by creating value through the assembly of such inputs. The record companies recoup those costs, avoid opportunity costs and generate profits by percent-of-revenue royalty pricing.

Thus, the Services’ criticism of the fact that Mr. Orszag’s approach does not capture some hypothetical inherent value of a sound recording is a red herring. *Cf. Phonorecords III*, 84 FR at 1931 n.64, 1946 n.110 (explaining why the existence of different pricing regimes for the same music demonstrates the absence of an “inherent value” in *copies* of musical works, notwithstanding the significant “first copy” value of musical works).

(4) Mr. Orszag’s Rate is Far Above the Present Statutory Rate

The Services note that Mr. Orszag’s \$0.0033 proposed benchmark rate is almost 50% above the statutory rate the Judges set in *Web IV* (originally \$0.0022, now \$0.0023 as adjusted for inflation) – using the same benchmarking approach Mr. Orszag claims to be following now. This substantial divergence is anomalous, according to the Services, and serves as a “red flag” that Mr. Orszag’s methodology departs significantly from *Web IV*. *See* 8/19/20 Tr. 2896-97 (Shapiro).

The Judges find this criticism wholly unpersuasive. Each rate case is a *de novo* proceeding, based upon the contemporaneous circumstances in the relevant markets (benchmark and target) as demonstrated by the record evidence. *Cf. Phonorecords III*, 84 FR at 1944 (“The statute is plain in its requirement that the rates be established *de novo*

each rate period”). There is no *a priori* reason why the rate in *Web V* should bear any particular relationship to the rate in *Web IV*. Moreover, this assertion appears self-serving because, as SoundExchange notes, Professor Shapiro advocates for a subscription royalty rate between \$0.0005 and \$0.0016, *far below* the current *Web IV* rate. Shapiro WDT at 2.

(5) Mr. Orszag’s Proposed \$0.0033 Per-Play Rate

[REDACTED] than the Effective Rate Paid by his Mid-Tier Proxies

Next, the Services assert that Mr. Orszag’s use of the three mid-tier proxies to generate his \$[REDACTED] per-play rate [REDACTED] than the \$[REDACTED] effective per-play rate actually paid by mid-tier services under the applicable percent-of-revenue rate. Shapiro WDT at 37-39 & tbl.9; 8/12/20 Tr. 1564-65 (Orszag); Orszag WDT ¶¶ 84-85; 8/13/20 Tr. 1958-59 (Orszag).

The Judges find this argument unpersuasive. For the Judges to make a meaningful comparison of Mr. Orszag’s proposed rate and the effective rates paid by mid-tier services, they would need evidence that sheds light on how those effective rates had been calculated from the actual percent-of-revenue rates (or other rate tiers) applicable to those mid-tier services. The Judges find that the record does not provide a basis to make such an examination.

(6) Mr. Orszag’s Benchmark Interactive Rates [REDACTED]

but he Proposes an Increase in the Statutory Noninteractive Rate

The Services criticize Mr. Orszag for – on the one hand – noting that benchmark interactive rates [REDACTED] while – on the other hand – calling for a significant increase in the noninteractive subscription royalty rate. But the Judges find that this reveals no *ipso facto* inconsistency. Factors particular to the noninteractive market could

cause the rate in that market to increase and converge with the subscription interactive rate, which could be falling. Additionally, SoundExchange notes that the operative marketplace metric in the benchmark interactive market changed from the per-play metric to the percent-of-revenue measure from the *Web IV* to the *Web V* period.¹³⁸ Thus, Mr. Orszag (who was not a witness in *Web IV*) has relied on new, contemporaneous material to generate his opinion regarding changes in the market. The Judges find that the deviation between his proposed rate arising from his expert analysis, and the prior rate, does not raise a concern.

**(7) Mr. Orszag’s Exclusion of Revenues and Royalties from
Discount Plans in his Calculation of Inputs [A] and [B] in
his Ratio Equivalency Model**

The Services assert that Mr. Orszag errs in excluding discount plans from his ratio equivalency model. SoundExchange responds by noting that the interactive services—Spotify in particular—engage in [REDACTED] discounting/price discrimination than the noninteractive services (or [REDACTED] in the model), such that including discount plans would fail to generate an apples-to-apples comparison. Orszag WRT ¶¶ 83, 87; 8/11/20 Tr. 1215 (Orszag).

This is essentially the reciprocal of SoundExchange’s criticism of Professor Shapiro’s *inclusion* of discount plans in calculating [B], his percent-of-revenue rate in the benchmark market (en route to a per-play rate in that market). Here, the Judges find no sufficient reason for Mr. Orszag’s exclusion of discount plan royalty and revenue data from his calculation of [A] (his total revenue input) and [B] (his total royalty input (en route to his percent-of-revenue rate in the benchmark market)). As the Judges explained in connection with the reciprocal argument pertaining to Professor Shapiro’s inclusion of

¹³⁸ The Judges discuss the significance of that change *supra*, section IV.B.1.e.ii.

such data, because the statutory rate will apply to all plays across all plans the per-play rate should be derived from data across all plans.

But SoundExchange makes a point that at first blush is anomalous: It notes that, had Mr. Orszag included discounted plans in his analysis, the [REDACTED]% percent-of-revenue rate he calculates would have increased to [REDACTED]%, Orszag WRT ¶ 89 n.198.¹³⁹ This has the effect, Mr. Orszag notes, *of increasing the royalty rate in his benchmark interactive market from \$0.0033 to \$0.0035*. Orszag WRT ¶ 89 & n.198; *see also* SX PFFCL ¶¶ 95-96. *Moreover, the Services expressly do not dispute that their criticism in this regard causes Mr. Orszag's benchmark rate to increase. See Services RPPFCL ¶¶ 95-96.*

So, why did SoundExchange decline to include the discounted plans in its analysis? As noted above, Mr. Orszag claims that he ignored discount plan data because the target mid-tier [REDACTED] service has far fewer discount subscribers, and he wants to make an apples-to-apples comparison. But the clear appropriateness of including discount plan data, together with the fact that including such data would have been significantly in SoundExchange's interest, makes its decision to exclude discount plan data something of a mystery, to say the least.

To wrap this mystery in an enigma, *the Services continue their own apparent self-destructive argument*, asserting that (1) the noninteractive market indeed offers a wide array of subscription plan discounts, including in particular SiriusXM's internet service, and (2) in any event, no economic principle supports Mr. Orszag's requirement of this particular apples-to-apples approach. *See Services RPPFCL ¶¶ 93-94. Perplexingly (at*

¹³⁹ Because the percent-of-revenue rate is [REDACTED]%, the [REDACTED]% rate which is inclusive of discount plans necessarily includes royalties that were paid on other prongs in the [REDACTED] in Spotify's license agreement. In fact, Mr. Orszag's calculation of a [REDACTED]% "undiscounted plan" royalty rate (rather than exactly [REDACTED]%) likewise suggests that Spotify paid [REDACTED].

least initially), *SoundExchange still declines to forego this argument and declare victory*, and simply accept the higher [REDACTED]% rate arising from the Services' criticism.¹⁴⁰ Likewise, the Services refuse to "let sleeping dogs lie" and stop arguing against themselves for an analysis that generates a rate of [REDACTED]% – which is [REDACTED]% above [REDACTED]%.

One may reasonably inquire: *What is going on here?*¹⁴¹ Why the facial anomaly of SoundExchange advocating for the *lower* [REDACTED]% of revenue rate and the Services arguing for the *higher* [REDACTED]%? The answer appears to lie in the fact that, under Professor Shapiro's approach, the higher royalty total in the benchmark market must be divided by the number of plays by subscribers. When Spotify's discount plans are included, the percentage increase in the total number of plays (the denominator) [REDACTED] than the percentage increase in royalties (the numerator). It appears to the Judges that Mr. Orszag and SoundExchange were willing to sacrifice applying the [REDACTED]% of revenue percentage that would have increased their proposed per-play rate to \$0.0035, in order to avoid relying on discount plans whose inclusion would bolster Professor Shapiro's model that includes discount plan play counts which thus decreases the per-play rate in the benchmark market. Conversely, Professor Shapiro and the Services were willing to acknowledge that if Mr. Orszag had included discount plans in his model, and the Judges fully applied his approach, they risked a higher statutory rate

¹⁴⁰ The difference between these rates is certainly not *de minimis*. SoundExchange argues, for example, that the [REDACTED] paid by Spotify to the Majors in their most recent contracts, from [REDACTED]% to [REDACTED]%, reflects [REDACTED] in the competitive nature of the upstream interactive market.

¹⁴¹ See JOHN KAY & MERVYN KING, *RADICAL UNCERTAINTY* at 10 (2020) (Two prominent economists, John Kay and Mervyn King, note: "The question 'What is going on here?' sounds banal, but it is not. ... [R]epeatedly ... people immersed in technicalities ... have failed to stand back and ask, 'What is going on here?'"")

of \$0.0035 per play. But the Services were apparently willing to take that risk, in order to bolster their general position that discount plan data be included, a position that, if adopted by the Judges, would add evidentiary weight to Professor Shapiro's model. In sum, it seems to the Judges that a good dose of game theory motivated the litigation strategy of the parties.

As discussed *supra* in connection with Professor Shapiro's benchmark, the Judges find that all revenues, royalties and plays, regardless of whether they are generated via discounted or undiscounted plans, must be included in the benchmarking analyses. That means Mr. Orszag's benchmark of \$0.0033 in fact should be increased to \$0.0035 when all discounted revenues, royalties and plays are included.¹⁴² Likewise, that means that Professor Shapiro's benchmark (interactive) effective per-play rate likewise properly considers all revenues, royalties and plays in that market. *See* Pandora/Sirius XM PFFCL ¶ 186 n.19 ("The effective per-play rate for *all plans*, as calculated by Professor Shapiro (\$[REDACTED]), is [REDACTED] than the per-play rate for solely full-priced plans (\$[REDACTED]).").¹⁴³

¹⁴² The Judges could leave Mr. Orszag's proposed rate at \$0.0033 per play, because he never revised his opinion to propose such a rate. However, the Judges take note that (as stated *supra*) the Services do not dispute the fact that including discount plans raise the per-play rate in Mr. Orszag's modeling to \$0.0035. Further, because the Judges are including discounted plan data in Professor Shapiro's modeling in that it makes economic sense to do so, the Judges find it is their obligation under the section 114 rate setting standard to utilize consistent economic analysis when evaluating Mr. Orszag's proposed rate model and resultant rates, when, as here, there is an evidentiary record to support such consistency.

¹⁴³ These per-play differences indicate the monetary impact of SoundExchange's *exclusion* of discount plans, even though they increased Mr. Orszag's proposed statutory rate from \$0.0033 to \$0.0035. That is an increase of 6.1%. However, if discount plans were likewise excluded from Professor Shapiro's analysis, his effective per-play rate would be reduced from \$[REDACTED] to \$[REDACTED], a decrease of

v. Explicit Adjustments to the Subscription Benchmarks of Professor

Shapiro and Mr. Orszag

Having considered the structures of the benchmarking and ratio equivalency models of Mr. Orszag and Professor Shapiro, and having considered the granular criticism of their respective applications of their models, the Judges now turn their attention to the choices made by these experts regarding whether to apply any additional, explicit adjustments to the subscription rates they derive from their models. And, if the Judges find that any additional adjustments are warranted, they determine the size of any such adjustment.

(A) Professor Shapiro's Proposed Second Interactivity Adjustment

Professor Shapiro's first interactivity adjustment is discussed *supra*, as it is part and parcel of his ratio equivalency model. But Professor Shapiro also proposes a second additional (*i.e.*, cumulative) interactivity adjustment, to be added on to his first interactivity adjustment.

According to Professor Shapiro, his first interactivity adjustment, while necessary, is not sufficient. The insufficiency arises, he asserts, because the mid-tier services that he utilizes to identify a retail price ([C] in his model) are not statutory noninteractive

[REDACTED]%. These per-play differences likewise explain why the Services wanted to *include* discount plans, because that inclusion (compared to full price plans only) reduced Professor Shapiro's benchmark rate [REDACTED] Mr. Orszag's benchmark rate. Assuming quite reasonably that neither SoundExchange nor the Services could predict with any certainty which of the two benchmark approaches the Judges were more likely to adopt (if either), or in what proportions, it made rational sense for them to make their best prediction of the outcome and then choose the approach to the discount plan inclusion/exclusion issue based on which position maximized their litigation return. If that is not what they did, then the Judges are left with the absurdity of both parties arguing against their interests, even after the issue had been joined in the proceeding.

services. Rather, as mid-tier subscription services, they offer limited interactivity, at a full retail price of \$4.99 per month. Shapiro WDT at 37-38, tbl.9; 8/19/20 Tr. 2828 (Shapiro). Thus, Professor Shapiro proposes an additional *second* “interactivity adjustment, which he avers is necessary to fully adjust for the difference between the value of a fully interactive service ([A] in his model) and a statutorily-compliant noninteractive service.

In support of this further adjustment, Pandora asserts that the general purpose for making an “interactivity adjustment” is to reflect the incremental downstream market value generated by interactive functionality. Pandora/Sirius XM PFFCL ¶ 188 (citing Shapiro WDT at 38-39, 42; 8/12/20 Tr. 1505-10 (Orszag). Professor Shapiro claims that his *first* interactivity adjustment follows the *Web IV* approach by identifying the ratio of: (1) subscription retail prices for his selected interactive services (identified above) to (2) subscription retail prices for his selected target market, the mid-tier services (also identified above). Shapiro WDT at 37-38 & tbl.9; 8/19/20 Tr. 2828 (Shapiro); *see also Web IV*, 81 FR at 26348. The average monthly full subscription price of the interactive services he reviewed was \$9.99. The average monthly subscription price of the mid-tier services he reviewed was \$4.99. Thus, the ratio of [A]:[C] is 2:1. Shapiro WDT at 37-39; 8/19/20 Tr. 2828 (Shapiro).

But because that first (implicit) interactivity adjustment measures – at the retail level ([A]/[C]) – the difference in the value of interactivity to consumers between a fully interactive service and a *partially interactive (mid-tier) service*, Professor Shapiro asserts that a *second* interactivity adjustment is necessary – to measure the value of the further difference between mid-tier level interactivity and a *noninteractive* (statutory) service. Shapiro WDT at 38-39; 8/19/20 Tr. 2830-33 (Shapiro).

However, unlike with his *first* interactivity adjustment, Professor Shapiro does not measure the difference in value by identifying a difference in the *downstream* market

between the (unregulated) retail values of: (1) the mid-tier *limited* interactive subscription services and (2) a measure of statutorily-compliant *non*interactive subscription services. Instead, Professor Shapiro examines the *upstream* market, comparing: (1) the effective per-performance *royalty* paid by consumers for his selected mid-tier subscription services, \$[REDACTED]; to (2) the 2019 statutory royalty for noninteractive services, \$0.0023, which was the most recent inflation-adjusted rate established by *Web IV*. Shapiro WDT at 37-39 & tbl.9. According to Professor Shapiro, using this upstream royalty differential is actually more direct than using the downstream retail price differential as a proxy for upstream value, because the purpose of the analysis is to determine the value of interactivity within the licensed rights *in the upstream market*. 8/19/20 Tr. 2830-32 (Shapiro). Thus, Professor Shapiro’s additional interactivity analysis results in a further adjustment, reducing his proposed statutory royalty (before any additional adjustments) by an additional [REDACTED]%. Shapiro WDT at 39.¹⁴⁴

Professor Shapiro further asserts that this second interactivity adjustment is consistent with the express language in *Web IV*. There, the Judges relied on the “ratio equivalency” argument proffered by SoundExchange’s economic expert, Professor Rubinfeld. As with Professor Shapiro’s approach, Professor Rubinfeld first compared ratios of interactive services to limited interactive services. The Judges utilized the implicit first adjustment discussed above. But additionally, as Professor Shapiro notes, the Judges found that Professor Rubinfeld should have made this second adjustment, if

¹⁴⁴ $[\text{REDACTED}] - [\text{REDACTED}] = [\text{REDACTED}]$. This royalty difference, in percentage terms, is $[\text{REDACTED}] \%$ (rounded), *i.e.*, $[\text{REDACTED}] / [\text{REDACTED}]$. Professor Shapiro expresses this royalty difference, equivalently, as the ratio of $[\text{REDACTED}] \div [\text{REDACTED}] = [\text{REDACTED}] : 1$ ($[\text{REDACTED}] \div [\text{REDACTED}] = [\text{REDACTED}]$ (rounded), and $[\text{REDACTED}] - [\text{REDACTED}] = [\text{REDACTED}]$, or $[\text{REDACTED}] \%$).

sufficient data was in evidence, to account for the different value of interactivity in the limited interactive market and the statutorily-compliant noninteractive market. Shapiro 8/19/20 Tr. 2832-33 (Shapiro).

Relying on the foregoing point from *Web IV*, Professor Shapiro then combines his 2:1 initial interactivity adjustment – reducing the effective royalty rate he had derived from the interactive market, \$[REDACTED] by 50%, down to \$[REDACTED]—and then *further reducing* that rate by an additional [REDACTED]% pursuant to his second interactivity adjustment, down to \$[REDACTED]).¹⁴⁵

SoundExchange does not disagree with Professor Shapiro’s assertion that a benchmark model consistent with *Web IV* requires an interactivity adjustment. However, SoundExchange avers that Mr. Orszag’s model, which it contends is more faithful to the *Web IV* approach, properly adjusts implicitly for the value of interactivity (as discussed *infra*). SX PFFCL ¶ 100.

SoundExchange argues that Professor Shapiro’s second interactivity adjustment is improper.¹⁴⁶ SoundExchange bases this argument on two assertions. First,

¹⁴⁵ \$[REDACTED] × [REDACTED] = \$[REDACTED] (rounded up from \$[REDACTED]).

¹⁴⁶ SoundExchange also contends that Professor Shapiro’s first interactivity adjustment, implicit in his model, is improperly inflated because Professor Shapiro (consistent with *Web IV*) utilizes only full retail value for [A] and [C] to identify his 2:1 interactivity ratio (as had been calculated in *Web IV*). Instead, SoundExchange avers that Professor Shapiro should have used the overall ARPU attributable to all retail plans, including the discount plans, which would have been lower than the average retail prices, especially in the interactive benchmark market (input [A] in the model). The Judges have discussed this issue in detail *supra*, section IV.B.1.d, in connection with SoundExchange’s criticism of Professor Shapiro’s selection of values for [A] and [C]. As explained there, the Judges ruled at the hearing that SoundExchange had failed to timely raise this issue, as required, in its written rebuttal statement and included rebuttal testimonies, and that it therefore constituted delinquent and improper “new analysis.”

SoundExchange notes that the additional functionality of the Pandora Plus mid-tier service (compared to the previous Pandora One statutory subscription service) [REDACTED], precluding reliance on a royalty rate nominally attached to a particular tier of service within that bundle. SX PFFCL ¶ 155 (and record citations therein). SoundExchange asserts that the [REDACTED] is confirmed by a Pandora executive, who testified that the purpose of this increased functionality in the mid-tier subscription service (compared with the noninteractive functionality of the former statutory subscription service) was to “creat[e] additional opportunities to upsell subscribers over time to Pandora Premium.” Phillips WDT ¶ 22. Accordingly, SoundExchange avers that Pandora’s WTP \$[REDACTED] for mid-tier functionality does not represent an unambiguous measure of the marginal value to Pandora of such functionality, but rather reflects, or certainly includes, the value of the mid-tier service as a marketing tool. Also, SoundExchange – relying on testimony from Professor Shapiro – speculates that [REDACTED]. SX RPFCL (to Pandora/Sirius XM) ¶ 197 (citing 8/19/20 Tr. 2962 (Shapiro)).

SoundExchange also emphasizes that the retail monthly subscription price for the Pandora Plus mid-tier service is \$4.99 – the same price as Pandora charged for its predecessor Pandora One statutory service. Phillips WDT ¶¶ 18, 20; Orszag WDT ¶ 179; 8/19/20 Tr. 2960 (Shapiro). SoundExchange relies further on Professor Shapiro’s testimony to assert that the absence of an increase in this subscription price demonstrates the absence of a marginal increase in market value from the additional mid-tier functionality, given that, under *Web IV*, the upstream demand for licensed interactivity is

Further, the Judges noted that the evidence in the hearing was inconclusive as to how ARPU is measured in the industry, and that the several ARPU values mentioned in other contexts were not sufficient to support the “new analysis” the Judges declined to admit into the record at the hearing.

a “derived demand,” *i.e.*, it is a function of downstream retail demand. 8/19/20 Tr. 2959-2960 (Shapiro) (“[T] this is derived demand. Since we’re talking about the subscription side, it would be based on the customers who were paying, the subscribers.”).

Pandora has a different explanation of how the concept of “derived demand” affects this second interactivity issue. Pandora asserts that it had anticipated, *ex ante* the Pandora Plus offering, that an increase in the downstream value of that service would be reflected in an increase in the *quantity* of Pandora Plus (mid-tier) subscriptions compared with the *quantity* of Pandora One (noninteractive) subscriptions, as Pandora maintained the \$4.99 monthly subscription price. SoundExchange discounts the economic value of this argument, asserting that only an increase in *revenue per play* unit—not a potential increase in total revenue – is probative of an increase in the value of the increase in licensed functionality. Orszag WDT ¶ 179 (“[T]here is no reason to think that the difference in functionality between Pandora One and Pandora Plus changed the amount of revenue per play”); 8/12/20 Tr. 1574 (Orszag) (“[T]he right question then to ask is: Was there a change in revenue per-play?”).

The Judges find Professor Shapiro’s attempt to make a second interactivity adjustment inappropriate. They find compelling the fact that the mid-tier retail \$4.99 monthly subscription price was unchanged from the monthly price for Pandora’s prior statutorily-compliant service (Pandora One). Also, the Judges find unwarranted Professor Shapiro’s reliance on the difference between the effective per-play upstream royalty rate Pandora agreed to pay (\$[REDACTED]) for its mid-tier Pandora Plus service and the statutory royalty rate of \$[REDACTED]. The interactivity adjustment as described in *Web IV* reflects differences in retail prices ([A] and [C]) in the ratio equivalency model), not upstream royalty rates. As SoundExchange correctly notes, those upstream rates can be affected by the fact that they are set in a contract that [REDACTED]. Further, as Professor Shapiro conceded in a colloquy with the Judges

during the hearing, the \$[REDACTED] effective per-play rate – by Professor Shapiro’s own conception of the Majors’ complementary power – could also embody a premium for that market power. 8/19/20 Tr. 2838-39 (Shapiro) (“it’s true that we might be getting a measure that is somewhat inflated [in] comparison [with] if there were more competition to offer those rights [Y]ou might want to give [the second interactivity adjustment] a haircut if you thought it was infected by complementary oligopoly power”); *see also* 8/25/20 Tr. 3644-46 (Peterson) (witness unable to preclude that the upstream royalty premium includes a market power effect that he treats as an interactivity value). However, Professor Shapiro did not parse the \$[REDACTED] rate to separate out this additional factor. In similar fashion, Professor Shapiro does not consider the extent to which the mid-tier services allow subscribers unlimited skips (plays of less than thirty seconds) for which no royalty is owed, unlike statutory noninteractive services (as discussed *infra*). Because the Judges are making separate adjustments for effective competition (to curtail the effect of the Majors’ complementary oligopoly power) and for skips, Professor Shapiro’s second interactivity adjustment could double-count those adjustments, as Professor Shapiro acknowledged in his colloquy with the Judges, quoted above.¹⁴⁷

¹⁴⁷ Although it might be possible to adjust the \$[REDACTED] royalty rate to parse the effective competition and skips values therein, Professor Shapiro did not do so at the hearing, and, in fairness to SoundExchange, the Judges find in the exercise of their discretion that it would be unreasonable for the Services or the Judges, *sua sponte*, to attempt to make these adjustments, post-hearing, in this Determination. *See Johnson v. Copyright Board*, 969 F.3d 363, (2020) (parties must be provided adequate notice of issues to be considered and resolved at the hearing, to “ensure[] that agencies provide a fair process in which each party is able ‘to present its case or defense ..., to submit rebuttal evidence, and to conduct such cross-examination as may be required for a full and true disclosure of the facts’ that bear on the agency’s decision and choices.”) (internal citation omitted).

Further, the second interactivity adjustment mentioned in *Web IV*, on which Professor Shapiro relies, did not provide for an adjustment based on an increase in the number of subscriptions sold and the increased revenue that may have resulted from those additional subscriptions. And, whether Pandora believed *ex ante* that it might generate additional revenue, or whether *ex post* some additional revenue may have been generated, there is no support for incorporating these revenue metrics into a model predicated on downstream retail prices.¹⁴⁸

Accordingly, the Judges shall not make this second interactivity adjustment.¹⁴⁹

(B) Professor Shapiro's Proposed Skips Adjustment

Professor Shapiro also proposes to apply a skips adjustment to his benchmark subscription rate. The skips adjustment, he avers, is necessary to account for the fact that [REDACTED], by contrast, noninteractive services do not have the right to avoid paying royalties for plays under thirty seconds under the Copyright Act. Shapiro WDT at 39. This difference in what constitutes a royalty-bearing play results in a [REDACTED] calculated per-play rate for on-demand services (who pay on a [REDACTED]) than for statutory services (who must pay for all plays). Peterson WDT ¶ 67.

¹⁴⁸ Professor Shapiro's attempt to rely on increases in revenues to support his second interactivity adjustment to his ratio equivalency adjustment appears to be inconsistent with his criticism of Mr. Orszag's reliance on a revenue-based application of the ratio equivalency model. Additionally, there is nothing in the record sufficient to indicate how any estimated increase in subscriptions (and thus revenues) generated by the mid-tier Pandora Plus service would impact the value of [C], given the inadequacy (discussed above) of simply applying the difference in upstream effective per-play royalty rates.

¹⁴⁹ Because the Judges reject Pandora's proposed second interactivity adjustment on other grounds, they do not address SoundExchange's argument that, because the mid-tier rate [REDACTED], the mid-tier rate cannot be examined in isolation.

In *Web IV*, as Professor Shapiro notes, the Judges applied a skips adjustment to correct for this disparity. *Web IV*, 81 FR at 26350-51, 26639; 8/19/20 Tr. 2847 (Shapiro). Moreover, the need to account for the play count differential in the benchmark and target markets is not disputed in this proceeding. 8/11/20 Tr. 1191 (Orszag); 8/25/20 Tr. 3632 (Peterson).

Applying the most current data for Pandora, Professor Shapiro determines that performances of less than 30 seconds constitute about [REDACTED]% of total performances. Shapiro WDT at 39. Accordingly, given Professor Shapiro's royalty rate of \$[REDACTED], which includes the first interactivity adjustment (but not the second interactivity adjustment rejected by the Judges *supra*), this skips adjustment would reduce that rate by [REDACTED]%.

SoundExchange questions the data on which Professor Shapiro relies in making his skips adjustment. Specifically, it notes that the data he uses to calculate this [REDACTED]% skips adjustment applies to noninteractive plays that were available on all three tiers of Pandora's service – ad-supported, mid-tier and fully interactive. *See* 8/20/20 Tr. 3028-29 (Shapiro). According to Mr. Orszag, this multi-tier sourcing of the skips data indicates that the Pandora skips rate is probably overstated. He bases this conclusion on the fact that the subscription tiers (Plus and Premium), unlike statutory services, provide their subscribers with unlimited skips, likely resulting in subscribers to those tiers skipping more songs. Orszag WRT ¶ 120. SoundExchange notes that Professor Shapiro agrees. *See* 8/20/20 Tr. 3030-32 (Shapiro).

In rebuttal, Professor Shapiro characterizes this issue as overblown, because [REDACTED]. Specifically, Pandora Plus and Pandora Premium have [REDACTED] and [REDACTED] subscribers, respectively, out of a total of [REDACTED] Pandora listeners. The remaining [REDACTED] listeners access Pandora Free. 8/20/20 Tr. 3031-

32 (Shapiro); Phillips WDT ¶¶ 5, 20-21. Accordingly, Professor Shapiro characterizes the number of noninteractive skips occurring on the subscription tiers is [REDACTED].

SoundExchange counters this point by noting that, although the impact of [REDACTED], Professor Shapiro nonetheless fails to measure this effect and reduce his skips adjustment accordingly. Conversely, the Services attack SoundExchange's criticism as being speculative and devoid of empirical support. The Judges find that, although there is no dispute that [REDACTED], SoundExchange does not bear the burden of quantifying, or at least estimating, the impact of the fact that listeners on the subscriber tiers would generate some of the reported skips. That is, because the adjustment is proffered by the Services, there is no apparent reason why SoundExchange should be required to assume the burden of proving the extent of the adjustment.

At a minimum, it is certainly reasonable, based on the record of the number of users and subscribers across Pandora tiers, as set forth above, that the percentage of skips would approximate the percent of Pandora customers who comprise the subscription tiers. That percent is [REDACTED]% ([REDACTED] ÷ [REDACTED]).¹⁵⁰ Applying this [REDACTED]% reduction in the [REDACTED]% the skips adjustment proffered by Professor Shapiro reduces that skips adjustment to [REDACTED]% (*i.e.*, [REDACTED] × ([REDACTED]-[REDACTED]) = [REDACTED] (rounded to [REDACTED]%). Thus, Professor Shapiro's proposed royalty rate, incorporating his first interactivity adjustment (but rejecting the second), of \$[REDACTED], needs to be reduced by

¹⁵⁰ The percentage of noninteractive skips attributable to subscribers might be *higher* than this percent, because subscribers have unlimited skips, but that percentage might also be *lower*, because subscribers have revealed a preference (by paying to subscribe) for utilizing on-demand features rather than noninteractive features. Thus, utilizing the relative percentages of subscribers is a reasonable middle ground for this small difference, and is certainly preferable to disregarding the skips adjustment in its entirety, when it is undisputed that such an adjustment is necessary.

[REDACTED]% to \$[REDACTED] (*i.e.*, $\$[REDACTED] \times (1-[REDACTED])$), which rounds to \$[REDACTED] per play.

This \$[REDACTED] per-play rate does not include an adjustment to generate a rate that offsets the Majors' complementary oligopoly power, in order to reflect a market that is effectively competitive. The Judges turn next to that adjustment.

(C) Professor Shapiro's Proposed Effective Competition

Adjustment

Before considering Professor Shapiro's proposed "effective competition" adjustment, it is instructive to recall the Judges' separate detailed analysis¹⁵¹ of the effective competition issue and the associated necessary adjustments. To summarize, the Judges offset the 12% effective competition adjustment by an appropriate portion of the [REDACTED] in the effective royalty rate (from [REDACTED]% to [REDACTED]%) that [REDACTED]¹⁵² [REDACTED] for any analysis in which Spotify is the benchmark or ratio equivalency comparator. If the benchmark is the interactive market as a whole, then the Judges apply the 12% effective competition adjustment, minus ([REDACTED]% \times the market revenue share attributable to [REDACTED] \times the share of their royalties paid at or about the [REDACTED]%-of-revenue level).

¹⁵¹ See *supra*, section III.

¹⁵² SoundExchange asserts that [REDACTED]% of revenue after Spotify obtained that [REDACTED]. However, there is insufficient detail in the record relating to [REDACTED]'s negotiations with the Majors, the overall structure of its rates and which tiers of service pay which rates. (In fact, there is evidence that [REDACTED] continues to pay royalties at a rate of [REDACTED] percent-of-revenue. Peterson WRT, tbl.5). Thus, the Judges do not lump the Apple royalty rate together with the Spotify rate, but they do include [REDACTED]'s data in connection with Professor Shapiro's overall industry data.

But Professor Shapiro proposes a different effective competition adjustment for his subscription benchmark.¹⁵³ As his “alternative market-power adjustment,” Professor Shapiro compares the royalty rate paid by [REDACTED] for its [REDACTED]. He relies on this comparison because of what he understands to be an important difference between the [REDACTED]: Whereas most interactive subscription services have a repertoire of approximately [REDACTED] songs they make available to subscribers, [REDACTED] subscribers have access to [REDACTED] songs. Given this disparity, Professor Shapiro opines that for [REDACTED] listeners the full repertoires of each Major are not “Must Haves,” because customers do not expect to find all their favorite artists and recordings on [REDACTED] as they would with a standalone interactive subscription service. Shapiro WDT at 37-40.

Professor Shapiro then takes note that the per-performance royalty rate paid by [REDACTED] for its [REDACTED] service is significantly below the general effective rate for interactive services. Specifically, he relies on the fact that the effective rate for [REDACTED] is \$[REDACTED] cents per play, compared with the \$[REDACTED] per-play effective rate for other interactive services. Relying on this difference, Professor Shapiro computes the ratio of the two rates – \$[REDACTED]/\$[REDACTED], which

¹⁵³ Professor Shapiro proffers an identical effective competition adjustment for his subscription benchmark rate and his ad-supported rate. Because he presents his ad-supported first in his WDT, he essentially incorporates by reference his ad-supported effective competition adjustment. The text immediately following this footnote, is based on Professor Shapiro’s substantively identical effective competition adjustment to his ad supported benchmark rate.

yields his proposed adjustment factor of [REDACTED]1, implying an effective competition adjustment of [REDACTED]%.¹⁵⁴ *Id.*

SoundExchange asserts that Professor Shapiro's subscription benchmark should not be reduced by an effective competition adjustment. It notes Professor Shapiro's characterization of [REDACTED]'s effective per-play rate of \$[REDACTED] as an effectively competitive rate. SoundExchange finds this assertion particularly important because that rate is essentially identical to Spotify's effective per-play rate on its subscription service of \$[REDACTED] per play.¹⁵⁵ *See* SX PFFCL ¶¶ 483-489 (and record citations therein). Moreover, SoundExchange emphasizes that Professor Shapiro himself concedes that the effective rate for Spotify's subscription service, in his opinion, is "the upper bound for a competitive rate." 8/20/20 Tr. 3116-17 (Shapiro).

Separate and apart from the foregoing issue, SoundExchange asserts that the [REDACTED] royalty rate is an inappropriate input for computing an effective competition adjustment. Specifically, SoundExchange argues that [REDACTED]'s royalty rate is [REDACTED] because: (1) [REDACTED] offers listeners only a limited number of new releases,¹⁵⁶ (2) [REDACTED], and (3) [REDACTED]. Orszag WRT ¶ 112; Trial Ex. 5610 ¶¶ 6-7, 9 (WRT of Aaron Harrison).

¹⁵⁴ The [REDACTED]:1 factor implies a percentage difference in the two rates of [REDACTED]%. The rate differential is thus $1 - [\text{REDACTED}] = [\text{REDACTED}]$. Thus, Professor Shapiro's proposed effective competition adjustment is [REDACTED]% (rounded).

¹⁵⁵ Spotify avers that, at most, a downward effective competition adjustment of approximately [REDACTED]% would be warranted for Professor Shapiro's benchmark, reflecting the difference between the \$[REDACTED] ([REDACTED]) and \$[REDACTED] ([REDACTED]) rates. SX PFFCL ¶ 487.

¹⁵⁶ SoundExchange notes that Professor Shapiro concedes it would be reasonable to reduce his [REDACTED]-based effective competition adjustment to reflect [REDACTED]'s possibly [REDACTED] have access. 8/20/20 Tr. 3120 (Shapiro).

In response, Pandora concedes that the use of [REDACTED] for this comparative analysis is not “perfect,” but asserts that benchmarking exercises are fraught with *inherent complexities*, and thus rarely meet that standard. Pandora also seeks to dismiss the defects in this aspect of its benchmarking exercise by noting that Mr. Orszag failed to identify the need for an effective competition adjustment. Pandora/Sirius XM PFFCL ¶ 219. These arguments are meritless. Although the Judges disagree with Mr. Orszag regarding the need for this adjustment, his opinion in no way serves to support Pandora’s reliance on [REDACTED]’s rate to propose a [REDACTED]% effective competition adjustment, which must succeed or fail on its own merits. And the acknowledgement by Pandora that this benchmarking exercise is less than perfect simply begs the question of whether it is so imperfect as to be given no weight in the Judges’ benchmarking analysis.

With regard to the substantive merits of Professor Shapiro’s proposed adjustment, Pandora does not deny that he acknowledges that his adjustment could reasonably be [REDACTED], particularly the [REDACTED]. However, Pandora chastises Mr. Orszag for failing to quantify the effect of the limited catalog. The Judges find Pandora’s response unavailing. Because it is *Professor Shapiro* who proffers [REDACTED] as a comparator for effective competition purposes, Pandora and he bear the burden of producing evidence that this limited service serves the purpose for which Professor Shapiro intends.

Pandora also asserts that [REDACTED]’s commercial presence – despite its limited repertoire – confirms that the catalogs of all Majors are not “Must Haves,” which is why its effective per-play rate is [REDACTED] \$[REDACTED]. 8/20/20 Tr. 3119 (Shapiro). The Judges disagree. [REDACTED]’s limited repertoire is more suggestive to the Judges of a significantly differentiated service compared to other interactive services and to noninteractive services. Because [REDACTED] is offered for

[REDACTED], and does not accept advertising, it is relatively unique.¹⁵⁷ There is no sufficient evidence in the record indicating that a subscription or ad-supported music service (interactive or noninteractive) could survive commercially if it operated with [REDACTED]’s limited repertoire.

Additionally, the Services make no response to SoundExchange’s contention that [REDACTED] receives a lower rate because it serves as a funnel, converting [REDACTED] listeners to [REDACTED] subscribers. The absence of a Services’ response is especially relevant because, as discussed *infra*, Professor Shapiro agreed that the funneling/conversion capacities of another interactive service, Spotify, need to be taken into account when using Spotify’s royalty rates (in the ad-supported market) as a benchmarking input.¹⁵⁸

The Judges now turn from the question of whether the [REDACTED] royalty rate is substantively an appropriate benchmarking input, to SoundExchange’s other argument – that if the \$[REDACTED] per-play [REDACTED] rate is an effectively competitive rate, then so too is Spotify’s effective \$[REDACTED] per-play royalty rate. The Judges find that SoundExchange’s assertion in this regard is of little practical importance as an opposition to Professor Shapiro’s subscription benchmark model.

If the Judges were to treat Professor Shapiro’s characterization of the [REDACTED] \$[REDACTED] per-play rate as essentially an admission that the Spotify

¹⁵⁷ In fact, [REDACTED]’s availability to all [REDACTED] suggests it is offered as a sort of “loss-leader,” rather than as a stand-alone downstream source for direct monetization.

¹⁵⁸ The Judges agree with the Services that SoundExchange’s claim that Amazon had relatively greater bargaining leverage (as the record companies’ primary physical product distributor) is belied by the [REDACTED] \$[REDACTED] per-play royalty rate for [REDACTED]. *See* Shapiro WDT at 42 tbl.10. But the other issues discussed above, are sufficient bases to doubt the usefulness of the [REDACTED] royalty rate as a benchmark.

effective per-play rate of \$[REDACTED] is also effectively competitive, the setting of a benchmark rate by the Judges would be little changed. Applying Professor Shapiro's proffered [REDACTED]% effective competition adjustment on his \$[REDACTED] interactive benchmark generates an effectively competitive rate of \$[REDACTED], (which would then be subject other potential adjustments). But the [REDACTED] rate of \$[REDACTED] that Professor Shapiro opines to be "effectively competitive" is *virtually identical* (and it too would then be subject to the same potential additional adjustments). Thus, substituting the [REDACTED] effective royalty rate for Professor Shapiro's effective competition adjustment would be inconsequential.

**(D) Professor Shapiro's Subscription Benchmark Rate as Adjusted
by the Judges**

In sum, the Judges find as follows with regard to Professor Shapiro's proposed subscription benchmark rate:

1. The effective interactive industrywide interactive benchmark rate of \$[REDACTED] per play is reasonable.
2. The first interactivity adjustment of 2:1 is appropriate, properly reducing his interim calculation to \$[REDACTED] per play (rounded).
3. The second (cumulative) interactivity adjustment is rejected.
4. The skips adjustment is reduced to [REDACTED]%, properly reducing the interim calculation to \$[REDACTED] (rounded).
5. The [REDACTED]% effective competition adjustment proposed by Professor Shapiro is rejected.
6. The Judges apply the lower effective competition adjustment supported by their overall "effective competition" analysis:
 - a. -[REDACTED]%

- b. $[\text{REDACTED}]^{159} \times [\text{REDACTED}]^{160}$
- c. $= [\text{REDACTED}] \%$
- d. $\$[\text{REDACTED}] \times (1 - [\text{REDACTED}]) = \$[\text{REDACTED}] \times$
 $[\text{REDACTED}] = \mathbf{0.0025}$ (rounded).

(E) Interactivity “Adjustment” to Mr. Orszag’s Benchmark

Mr. Orszag avers that his benchmark model directly and implicitly accounts for the difference in interactivity between the benchmark and target markets, and that any further such adjustment would be unnecessary and improper. In particular, he states that it is his use of the effective percentage of revenue rate paid by interactive subscription services that allows his model to account for the impact of interactivity. More specifically, he testifies that, when he multiplies that benchmark percent-of-revenue rate by the lower revenues in the target market (relative to the benchmark market), the product equals a lower royalty. This lower royalty, he concludes, reflects the lower value consumers place on a service that lacks on-demand functionality. Orszag WDT ¶ 79. Alternately stated in terms of the ratio-equivalency model, the interactivity difference is implicitly modeled because the revenue figure in the target market – the right-hand numerator [C] – is substantially less than the revenue figure in the benchmark (interactive) market numerator [A] – given that the benchmark subscription service price is substantially higher than the subscription price in the benchmark market and the number of subscriptions in the benchmark market is substantially greater.

The Services do not make any specific challenge to Mr. Orszag’s claim that his model implicitly includes an interactivity adjustment. To be sure, the Services vigorously challenge the appropriateness of his model, including its failure, in their opinion, to

¹⁵⁹ See Orszag WDT tbl.4.

¹⁶⁰ See Peterson WRT fig.5; see also 8/25/20 Tr. 3706 (Peterson) [REDACTED]; 8/11/20 Tr. 1209 (Orszag) (As between the [REDACTED])

properly apply the ratio equivalency benchmarking model in *Web IV*.¹⁶¹ But, assuming *arguendo* that Mr. Orszag's subscription benchmarking model is otherwise appropriate, the Services offer no new or specific criticism regarding its implicit interactivity adjustment, as explained by Mr. Orszag.¹⁶²

(F) Skips Adjustment to Mr. Orszag's Benchmark

According to Mr. Orszag, his benchmarking model also directly and implicitly accounts for the skips differential from the benchmark market to the target market, despite the fact that his benchmark data is weighted very heavily toward Pandora, which, under its direct license agreements with the record companies, pays royalties for skips (unlike the benchmark services). This difference does not affect Mr. Orszag's proffered per-play royalty rate because in his model he divides the target market's total royalties due by the number of target market plays—including skips – yielding a per-play rate that accounts for skips. That per-play rate accounts for skips because (1) the royalties generated by the skips are included in the numerator *and* (2) the number of skips are included in the denominator, in the same manner as full plays, thus canceling each other out and not changing the per play royalty calculation. 8/11/20 Tr. 1191-92, 1249-50 (Orszag).¹⁶³

¹⁶¹ See discussion *supra*, section IV.B.1.e.

¹⁶² The Services do criticize Mr. Orszag for not making a “second” interactivity adjustment to reflect the greater interactivity of the mid-tier services that constitute Mr. Orszag's target market, relative to the *noninteractivity* of statutory services. However, as explained *supra*, section IV.B.1.e.v(A), in connection with Professor Shapiro's proposed further interactivity adjustment, the Judges find no sufficient evidence in the record or basis in the *Web IV* approach to support a finding that there is greater market value in these mid-tier services compared with statutory services.

¹⁶³ For example, assume all plays (including skips) generate \$240,000 in royalties (the numerator), and the total number of plays (including skips) totals 120,000,000 plays. The per-play royalty (including skips) is

In his WRT, Professor Shapiro asserts that Mr. Orszag had improperly failed to make an explicit skips adjustment. Shapiro WRT at 33. At the hearing, however, Professor Shapiro acknowledges that Mr. Orszag's approach indeed *does not* require a separate skips adjustment. 8/20/20 Tr. 3025-26 (Shapiro).

The Judges agree that Mr. Orszag's ratio equivalency benchmarking model, to the extent it is otherwise useful and appropriate, does not require a skips adjustment.¹⁶⁴

(G) Effective Competition Adjustment to Mr. Orszag's Benchmark

As explained in the separate section of this Determination analyzing the effective competition issue, SoundExchange maintains that the enhanced power of its benchmark interactive service, Spotify, has allowed it to exert countervailing power in its

$\$0.0020$ ($\$240,000 \div 120,000,000$ plays = $\$0.0020$). Now also assume 20,000,000 of these plays were skips. If in Mr. Orszag's model skips were explicitly eliminated, there would be only *100,000,000 plays in the denominator* ($120,000,000$ plays – $20,000,000$ plays = $100,000,000$ plays), and only *$\$200,000$ in royalties in the numerator* ($\$240,000 - (20,000,000 \text{ plays} \times \$0.0020 \text{ in royalties}) = \$240,000 - \$40,000 = \$200,000$). Now, with skips eliminated, $\text{Royalties} \div \text{Plays} = \$200,000 \div 100,000,000 = \0.0020 – the same per-play royalty rate with or without skips.

¹⁶⁴Mr. Orszag acknowledges though that the two services other than Pandora included in his model's target market (iHeart and Rhapsody) do not report or pay for skips, which would require a skips adjustment. However, according to Mr. Orszag, those two services constitute a *de minimis* portion of the total plays in his target market. See 8/11/20 Tr. 1230 (Orszag). The Services agree that: (1) Mr. Orszag's ratio equivalency approach is [REDACTED]'s revenue-per-play; (2) Pandora pays for skips; and (3) the net effect of (1) and (2) is to minimize the impact of Mr. Orszag's failure to include a skips adjustment for iHeart and Rhapsody. Nonetheless, the Services aver that the absence of a skips adjustment for the iHeart and Rhapsody plays has an "unquantified effect" on Mr. Orszag's benchmark subscription royalty rate. Services RPFCL ¶ 240. Although a benchmark proponent should quantify or estimate a benchmark input that would be significant, here the Judges find that the Services have essentially acknowledged the correctness of Mr. Orszag's skips analysis, and that the "unquantified effect" would be of little consequence.

negotiations with the Majors that fully offsets their complementary oligopoly power. *See* SX PFFCL ¶¶ 259-493 (asserting that no competition adjustment is required because the benchmark agreements on which Mr. Orszag's analysis is based reflect effectively competitive rates). For this reason, Mr. Orszag makes no effective competition adjustment to his proposed subscription benchmark rate.

However, as the Judges stated *supra* in their analysis and findings regarding the effective competition adjustment, it is appropriate to adjust downward Mr. Orszag's Spotify-based ratio equivalency rate as follows:

- (1) apply the 12% downward adjustment;
- (2) [REDACTED] that adjustment by [REDACTED] percentage points to reflect Spotify's [REDACTED]; and
- (3) multiply the rate from step (2) by [REDACTED]%, the percent of revenue paid by Spotify at the [REDACTED]% level).¹⁶⁵

**(H) Mr. Orszag's Subscription Benchmark Rate as Adjusted by
the Judges**

The Judges do not make any adjustments to Mr. Orszag's proffered benchmark other than the foregoing effective competition adjustment. Based upon the analysis in the Judges' discussion of effective competition, *supra*, they calculate their effective competition adjustment to Mr. Orszag's \$0.0033 benchmark per-play rate as follows:

1. The Judges adjust Mr. Orszag's proffered benchmark rate to reflect both the complementary oligopoly power of the Majors (12%) and, in partial mitigation, the extent to which Spotify paid the [REDACTED] percent-of-

¹⁶⁵ Unlike their adjustments to Professor Shapiro's approach, the Judges do not reduce Spotify's impact by multiplying by Spotify's market share, because Mr. Orszag uses only Spotify data in his benchmark market analysis, whereas Professor Shapiro uses a weighted average of multiple interactive services in his benchmark market analysis.

revenue royalty rate instead of the [REDACTED]% rate (reflecting Spotify's bargaining power).

2. The [REDACTED] of this royalty rate from [REDACTED]% to [REDACTED]% reflects a [REDACTED]% [REDACTED] royalties.
3. To determine the extent to which Spotify paid (approximately) the [REDACTED] percent-of-revenue rate, the Judges note that [REDACTED]% of its royalties were paid on that basis. Peterson WRT, fig.5.
4. $[REDACTED]\% \times [REDACTED] = [REDACTED]\%$ (rounded).
5. The complementary oligopoly adjustment is [REDACTED]% - [REDACTED]%, which equals [REDACTED]%.
6. Mr. Orszag's adjusted rate is calculated as $\$[REDACTED] \times (1 - [REDACTED])$, which equals **\$0.0032** (rounded).

f. The Judges' Synthesis of the Adjusted Rates of Professor Shapiro and Mr. Orszag

As explained *supra*, Professor Shapiro's benchmark approach has a weight of 88.5%, and Mr. Orszag's has a weight of 11.5%, in the Judges synthesized rate based on the benchmark/ratio equivalency approach. The synthesis of their two models, as adjusted by the Judges, is set forth below:

The Shapiro Subscription Benchmark Rate:

$$\$0.0025 \times 0.885 = \$0.00221$$

+

The Orszag Subscription Benchmark Rate:

$$\$0.0032 \times 0.115 = \$0.00037$$

=

$$\$0.00258 \text{ rounded to } \mathbf{\$0.0026}$$

Accordingly, the Judges find that the benchmark-derived rate for noninteractive subscription services is **\$0.0026 per play**.

2. The Ad-Supported Benchmark Models¹⁶⁶

a. SoundExchange's Ad-Supported Benchmark Model

On behalf of SoundExchange, Mr. Orszag uses a benchmarking analysis quite similar to his subscription benchmark model considered *supra*. First, although he is modeling the ad-supported market, his approach again looks to the *subscription* interactive market as the benchmark, using Spotify as the proxy. Next, he calculates an effective percent-of-revenue royalty paid by Spotify in the subscription interactive market, and then converts that benchmark percent-of-revenue rate into an ad-supported per-play rate by dividing royalties by the number of noninteractive plays. Orszag WDT ¶ 96.

Mr. Orszag acknowledges that in *Web IV* the Judges rejected this approach, *i.e.*, the use of *subscription* interactive services as a benchmark for *ad-supported* noninteractive services. *See Web IV*, 81 FR at 26344-46 (significant divergence in WTP between downstream subscription and ad-supported consumers negates a finding of substantial cross-substitution from subscribership to “free to the listener” use, thus rendering inapplicable Professor Rubinfeld’s attempted extension of the ratio equivalency approach to the ad-supported calculation of ad-supported royalties). Notwithstanding this *Web IV* finding, Mr. Orszag opines that his particular model, and new market developments, combine to distinguish his approach from that rejected in *Web IV*.

First, in his WDT, Mr. Orszag asserts that the present record evidence demonstrates there is sufficiently greater substitution between the benchmark and target

¹⁶⁶ The Judges use the phrase “ad-supported services” to refer to nonsubscription services throughout this Determination.

markets than was shown in *Web IV*, justifying his use of interactive services as a benchmark for ad-supported services. Orszag WDT ¶ 88. Moreover, Mr. Orszag takes issue with the Judges' finding in *Web IV* that the ad-supported listeners did not reveal a positive WTP. He asserts that, from an economic perspective, listeners reveal a positive WTP, in that they subject themselves to listening to advertising, which, he argues, is itself a form of payment in time rather than in money.

However, Mr. Orszag does not attempt to measure the dollar value of that time to these listeners. Rather, he notes that the noninteractive services earn revenue from the advertising revenue they receive for making advertising time available on those services, a portion of which the noninteractive services can pay as royalties to the record companies. Mr. Orszag avers that, if it were really true that listeners to ad-supported service have a zero willingness to pay, then ad-supported *services* themselves should also have zero willingness to pay, which plainly is not the case. Orszag WDT ¶ 90; 8/11/20 Tr. 1240-41 (Orszag). Mr. Orszag also points to record evidence, including Pandora documents, indicating that [REDACTED]. Trial Ex. 5056 at 26. Another Pandora document on which Mr. Orszag relies states that “[REDACTED]” Trial Ex. 5061 at 2; Orszag WDT ¶ 93.

Nonetheless, although Mr. Orszag acknowledges that the sound recording and streaming industry perceives ad-supported listeners as having a “low” WTP, Orszag WRT ¶ 75, SoundExchange points out that a Services' witness, T. Jay Fowler, Director of Product Management for Music Products at YouTube (a division of Google), speculates that this “may be only a temporary or transitory phenomenon,” because consumers need time to understand the value of streamed music and thus make the switch from an ad-supported to a subscription service. Trial Ex. 1100 ¶ 17 (WDT of T. Jay Fowler); SX PFFCL ¶ 164. In furtherance of this argument, Mr. Orszag also relies on evidence from Professor Willig's application of data from the Zauberman Survey, which

Mr. Orszag characterizes as showing a high cross-elasticity of demand for noninteractive ad-supported listening and interactive ad-supported subscribership. That survey evidence, as applied by Professor Willig, indicates that 9.1% of respondents would switch from ad-supported noninteractive services to a new on-demand subscription, if their ad-supported noninteractive service was not available. Willig WDT ¶ 47, fig.6 (panel A).¹⁶⁷

Based on the foregoing rationale, Mr. Orszag utilizes the same “ratio equivalency” model as he used for the subscription tier. SoundExchange summarizes his application of this approach to the ad-supported model as follows:

[A] and [B] remain the total revenue earned by and total royalty paid by Spotify for its subscription interactive service. As before and for the same reasons provided in Mr. Orszag’s benchmark analysis for noninteractive subscription services ... the analysis conservatively uses the effective [percent of royalty] rates paid by Spotify as the basis for the proposed per-play rate for statutory ad-supported noninteractive services.... And as before, Mr. Orszag excluded family, student, military, employee, and trial and promotional products in calculating the effective rates because these products are unlikely to be relevant to an ad-supported service.... [C] is now the revenue earned by the [noninteractive] ad-supported service.

SX PFFCL ¶¶ 168-169 (and record citations therein).¹⁶⁸

¹⁶⁷ The Hanssens Survey indicates, according to Professor Shapiro, that this diversion to new interactive subscriptions would be [REDACTED], measuring [REDACTED]%. Shapiro WDT at 21, tbl.2. This lower figure would not alter the weights assigned to the benchmarking and ratio-equivalency models. The Judges note, though, that despite finding the Zauberman Survey less reliable in other respects than the surveys by Professors Hanssens and Simonson (the latter replicating Professor Hanssens’s survey work) only the Zauberman Survey asks respondents directly to identify the source of music to which they would divert if noninteractive subscription services were not available (The Hanssens and Simonson surveys ask more ambiguously what respondents would do if they noticed all relevant services had stopped streaming songs by some popular artists and some newly released music. Hanssens WDT ¶¶ 13, 21-22.)

¹⁶⁸ As with his subscription model, Mr. Orszag excluded family, student, military, employee, and trial and promotional products in calculating the effective rates, claiming that these products would not likely be

The effective percent-of-revenue rate in Mr. Orszag's benchmark market, [B]/[A], of course remains at [REDACTED]% (because he uses the same benchmark market). Mr. Orszag multiplies that [REDACTED]% effective rate by the noninteractive ad-supported gross revenue for Pandora and iHeart, and then divides by the corresponding number of plays in the target noninteractive ad-supported market. *Id.* ¶ 98.¹⁶⁹ His computations and results are set forth in the table below (excerpted from Orszag WDT tbl.9):

Table 9 – Noninteractive Ad-supported Benchmark, May 2018 – April 2019

[RESTRICTED]

[REDACTED]

The resulting proposed royalty rate for noninteractive ad-supported services is \$0.0025 per play, as presented in the right-hand column of the table above. *Id.* ¶ 99.¹⁷⁰

relevant to an ad-supported service. Orszag WDT ¶ 97. And, as noted in the above quote, for the revenue of noninteractive services ([C] in his model) Mr. Orszag uses revenue earned by Pandora and iHeart.

8/11/20 Tr. 1248 (Orszag); Orszag WDT ¶ 98.

¹⁶⁹ Calculated from a different perspective, Pandora and iHeart's combined average revenue per play was \$[REDACTED] [REDACTED] for the twelve-month period ending April 2019. This average revenue per play, when multiplied by the percentage-of-revenue royalty rate for interactive subscription services, results in the per-play royalty rates for noninteractive ad-supported services. *Id.* ¶ 98.

¹⁷⁰ With regard to potential adjustments to his proposed rate, Mr. Orszag opines first that, as with his subscription benchmark model, his ad-supported mode contains an implicit interactivity adjustment, because it relies on the lower revenue of the ad-supported noninteractive market as the value of [C] (compared to the higher revenue of the benchmark interactive subscription market. Next, Mr. Orszag finds

b. The Services' Criticism of Mr. Orszag's Benchmark Ad-Supported Model in his WDT

As an initial matter, the Services criticize the fundamentals of Mr. Orszag's ratio equivalency model in this ad-supported context for the same reasons they criticize his use of this model formulation in his subscription market analysis. Again, they criticize what they construe as Mr. Orszag's improper re-characterization of the *Web IV* ratio equivalency approach because he: (1) defines [A] and [C] as revenue inputs; (2) fails to identify a per-play rate [B] in the benchmark market; (3) applies the percent-of-revenue paid in the benchmark market to the target market; and (4) uses play counts in the target market instead of the benchmark market to generate per-play rates.

Additionally, the Services criticize Mr. Orszag's decision to input the percentage-of-revenue royalty rate applicable to *subscription* interactive services as an appropriate data point for calculating the *ad-supported* noninteractive royalty, given the clear rejection of that approach in *Web IV*. Further, the Services aver that Mr. Orszag's ad-supported modeling: (1) fails to address the difference in the ways the two services generate revenue (advertising versus consumer subscription payments); (2) fails to demonstrate (or even calculate) comparable demand elasticities between the two categories of services as required by *Web IV*; (3) fails to demonstrate comparable WTP as the between the ad-supported and subscription services; (4) fails to demonstrate an opportunity cost even close to approximating the 1:1 opportunity cost (cross-elasticity) between the two categories of service; and (5) fails to apply Spotify's own ad-supported rates into the analysis. Services RPFCL ¶ 158 (and record citations therein)

no reason to make either a skips or an effective competition adjustment, for the same reasons discussed *supra* in connection with his subscription benchmark model.

Among these criticisms, the Services highlight what they assert are the two *principal* problems in Mr. Orszag's model. First, they point to his decision to duplicate his subscription "ratio equivalency" model by simply substituting noninteractive ad revenue for subscription revenue. They note that the identity and motivations of the different classes of payors—advertisers who pay for listeners' attention, on the one hand, and subscribers who pay for uninterrupted access to music, on the other – renders misguided any attempt to apply the ratio equivalency model in this manner.

Further, the Services emphasize that Mr. Orszag fails to demonstrate how users' willingness to listen to ads can be converted into a dollar value. What the market evidence does reveal, the Services state, is directional in nature – that the amount such users would pay (if any) *must be less* than the subscription price of an on-demand service. *See* Leonard WRT ¶ 54 (noting that, by revealed preference, consumers have demonstrated that their WTP to avoid ads is less than that of subscribers to paid services); *see also* Peterson WRT ¶¶ 38, 40.

Relatedly, the Services maintain that Mr. Orszag does not provide a reason for his assumption—incorporated into his model—that the amount advertisers pay to transmit ads to noninteractive listeners is actually a proxy for the WTP for music of noninteractive listeners. *See* Peterson WRT ¶ 38 (advertiser WTP for listener attention may be completely unrelated to listeners' WTP for music, and therefore is not a basis to assert that ad-supported services, whose listeners are clearly price sensitive, have an elasticity of demand comparable to that of subscription services); *see also* 8/25/20 Tr. 3702-03 (Peterson) (same). In fact, the Services argue that advertising revenue generated by an ad-supported service is materially determined by that service's *own investment and skill* in building an advertising platform that will attract advertiser dollars. 8/20/20 Tr. 3248 (Shapiro). And, in particular, Pandora has invested significantly to create its advertising

platform, allowing it to receive substantially higher advertising rates and more advertising revenue than other “free-to-the listener” noninteractive streaming services.

Specifically, the Services, and Pandora in particular, emphasize Pandora’s unique ability to attract and monetize advertisers—a return on its investment of billions of dollars. They note that this revenue generation is unconnected to the level of functionality it offers. 8/20/20 Tr. 3218-20 (Shapiro) (testifying that Pandora’s investment in “systems [on] which ... advertisers compete for ... space” increases the per-play revenue Pandora receives in a way that has “nothing to do with the rights they have licensed, but, rather, with their own capabilities.”); Herring WDT (*Web IV*) ¶ 11 (“Pandora derives more than 80% of its revenue from the sale of advertising”).

Further in this regard, the Services maintain there is no evidence that advertiser payments are correlated with the particular level of *interactivity* offered by a service, a correlation, they assert, is implicitly assumed by Mr. Orszag’s adoption of a ratio equivalence relationship between subscriber payments in the interactive space and advertisers’ payments in the noninteractive space. *See* Services PFFCL ¶¶ 26-27 (and citations therein). As Dr. Leonard testifies, advertisers “have no reason to prefer advertising on a service with greater interactivity” Leonard WRT ¶ 54.¹⁷¹

Even if listeners’ tolerance for advertisements could be construed as a form of “payment” for noninteractive listening, the Services maintain that this would still be insufficient to justify Mr. Orszag’s adoption of a ratio equivalence between the two broad categories of services. *See* Shapiro WRT at 38-40 (*citing Web IV*, 81 FR at 26349); Peterson WRT ¶¶ 36-40 (*citing Web IV*, 81 FR at 26353). More specifically, the Services

¹⁷¹ The irony of this criticism by the Services is not lost on the Judges. On the one hand, the Services argue that interactivity is irrelevant on the ad-supported tier, because the payors (the advertisers) are uninterested in the functionality of the system. Yet, as discussed *infra*, the Services propose that the Judges make *two interactivity adjustments* to the ad-supported rate.

maintain that Mr. Orszag's model cannot address the Judges' point in *Web IV* that "[t]he ratio equivalency approach assumes that listeners who willingly pay for a subscription to a service have a WTP *equal to* the WTP of those who use ad-supported (free-to-the-listener) services." *Web IV*, 81 FR at 26345. (emphasis added). Moreover, the Services point out that Mr. Orszag himself concedes that consumers of advertising-supported and subscription services have a different WTP. 8/12/20 Tr. 1548 (Orszag). This underscores the relevance of the Services' claim that Mr. Orszag did not provide, or even attempt to provide, the demonstration of comparable demand elasticities that the Judges previously required. *See Web IV*, 81 FR at 26349. And the Services point to Dr. Peterson's testimony, in which he notes that the low WTP of ad-supported listeners indicates that their demand is far more elastic than the demand of interactive subscribers. 8/25/20 Tr. 3702 (Peterson); Peterson WRT ¶37.

Turning to the particular issue of *cross-elasticity*, the Services note the Zauberman Survey, as applied by Professor Willig, reveals that about 90% of ad-supported noninteractive listeners are *unwilling* to pay for a subscription interactive service. Services RPFCL ¶ 165. This point, the Services claim, underscores the importance of their criticism that neither Mr. Orszag nor the survey evidence demonstrates the existence of a sufficiently high cross-elasticity of demand between ad-supported noninteractive listening and subscription interactive (on demand) listening to support the application of Mr. Orszag's ratio equivalency. In this vein, the Services emphasize that Mr. Orszag does not deny that he has *not* demonstrated the 1:1 opportunity cost required by the *Web IV* "ratio equivalency" approach, *i.e.*, that, in this context, a dollar spent by an advertiser on an ad-supported noninteractive service would otherwise be spent on a subscription to an interactive service, or, alternatively, that if users discontinued listening to an ad-supported noninteractive service, the resulting

reduction in advertising revenue would otherwise create a commensurate increase in subscription revenue for an interactive service. *See* 8/13/20 Tr. 1948 (Orszag).

The Services further claim that SoundExchange's reliance on Pandora's internal documents, Trial. Exs. 5056 and 5061, is misplaced. They point out that neither of these documents actually shows how many [REDACTED]. Services RPPFCL ¶ 163 (and record citations therein). Similarly, the Services maintain that SoundExchange has the relevant direction of the evidence wrongly reversed with regard to its analysis of Spotify's customer behavior. That is, the fact that [REDACTED] % of Spotify's subscribers had originally used Spotify's ad-supported service provides no useful information regarding the appropriate metric: how many Spotify ad-supported users in fact have a WTP for a Spotify subscription. Indeed, the Services note, SoundExchange's argument in this regard is belied by Mr. Orszag, who acknowledges that only [REDACTED]% of Spotify's ad-supported listeners convert to Spotify's subscription tier within the first two years using Spotify's ad-supported service. Services RPPFCL ¶ 164 (citing Orszag WRT ¶ 75 n.167).

c. The Judges' Analysis and Findings regarding Mr. Orszag's Ad-Supported Benchmark Model from his WDT

The Judges reject the ad-supported model Mr. Orszag presents in his WDT.¹⁷² At an obvious level, his approach deviates from the Judges' finding in *Web IV*, in which they rejected the use of a ratio equivalency formula that utilized subscription inputs on the

¹⁷² Alternatively, in his *WRT and hearing testimony*, in response to the models proffered by Professor Shapiro and Dr. Peterson, Mr. Orszag acknowledges that it is also reasonable to rely on Spotify's effective *ad-supported* percent-of-revenue paid as the benchmark rate, rather than the subscription percent-of-revenue it pays (as he proposes in the benchmark model) in his WDT. The Judges analyze Mr. Orszag's alternative approach *infra*, after considering the models proposed by Professor Shapiro and Dr. Peterson, that also use Spotify's ad-supported service as a benchmark.

left-hand benchmark side of the model. Moreover, Mr. Orszag's *rationale* for his departure from *Web IV* is unavailing. There is simply no evidence to support his assertion that there is anything approaching a 1:1 substitutability (cross-elasticity) from interactive services to noninteractive services.

Perhaps in recognition of the fact that the 9.1% substitution figure he cites from the Zauberman Survey does not reflect significant cross-elasticity, Mr. Orszag adds in a footnote, that "no particular level of cross-elasticity is necessary for one market to serve as an appropriate benchmark for another market." To support this point, he presents as an example, quoted in part *supra*, the hypothetical that the subscription price for a cable television service in Chicago may be "an ideal benchmark" to use in order to set an appropriate subscription price for a cable television service in Philadelphia, "even though there is zero cross-elasticity for cable services between the two cities, because residents of Philadelphia cannot access the Chicago service and vice versa." Orszag WDT ¶ 95 n.132. But this example only underscores the narrow relevancy of a ratio equivalency approach and its implicit assumption of a substitutability of (or proximate to) 1:1, to constitute effective cross-substitutability.¹⁷³

In this regard, Mr. Orszag's "inter-city" analogy reflects a subtle but important shift in his reasoning: He is dispensing with the *Web IV*/Professor Rubinfeld underpinning of the ratio equivalency model – high cross-substitutability (assumed or actual) – and asserting that his approach is consistent with the more traditional pure benchmarking approach, which relies on the *similarity* – *not the cross-elasticity or substitutability* – between sellers/licensors, buyers/licensees, and the rights being

¹⁷³ The Judges incorporate by reference here their citations to *Web IV* and *SDARS III*, *supra*, in their consideration of Mr. Orszag's subscription model, pertaining to the import of the absence of sufficient cross-elasticity. See discussion *supra*, section IV.B.1.e.ii.

transferred between the benchmark and target products. *The Judges' discern from Mr. Orszag's distinction a confirmation of their rationale for relying substantially on Professor Shapiro's benchmarking approach, because the cross-elasticity/substitutability revealed by the record is relatively low, whether in the subscription market (as discussed supra) or in the ad-supported market (as discussed here).*¹⁷⁴

The Judges also place no weight on Mr. Orszag's assertion that the willingness of ad-supported listeners to subject themselves to advertisements indicates a positive WTP. Although there is certainly disutility in listening to advertising that is annoying,

¹⁷⁴ The Judges also agree with the Services that Mr. Orszag's failure to estimate the own-elasticities of demand for his benchmark and target services compromises his attempt to apply the *Web IV* benchmark approach. "Own-elasticities" of demand reflect the responsiveness of quantity demanded to increases or decreases in the price of a product – typically a negative (inverse) relationship, as represented in the downward-sloping demand curve. Cross-elasticity measures the responsiveness of demand for product A in response to a change in the price of product B – a positive relationship for substitute products. *See generally* ROBERT S. PINDYCK & DANIEL L. RUBINFELD, MICROECONOMICS at 33-36 (8th ed. 2013).

As the Judges have noted in both *SDARS III* and *Web IV*, a significant level of cross-elasticity (proven or reasonably presumed) is necessary for the ratio-equivalency model to be broadly applicable, or else, as here, its application is limited by the extent of cross-elasticity demonstrated between the benchmark and target markets. Own elasticities can also be relevant because they indicate the relative pricing power of each tier of service (a low elasticity (*i.e.*, high inelasticity) indicates relatively greater pricing power, and *vice versa*, pursuant to the Lerner Equation discussed in *Web IV*). If own-elasticities are roughly equal, then the services have a roughly equal concern over the impact on quantity (and thus revenue) of a change in retail prices, making the ratio equivalency model more appropriate, *ceteris paribus*. Further, high own-elasticity can be *suggestive* of significant cross-elasticity with regard to clearly substitutable products. A relatively high own-elasticity suggests that a given percentage increase in price will engender a larger percentage decrease in quantity, that is likely to result in substitution of a product sufficiently similar in price and characteristics, even in the absence a more specific measuring of cross-elasticity, such as through the use of consumer surveys.

uninformative or irrelevant, other advertising can be pleasant or amusing (or at least neutral), informative or relevant. Also, advertising interruptions allow a user to take advantage of the break to attend to other personal necessities. Moreover, ad-supported listeners are made aware of the presence of advertising, so they are already a self-selected cohort of consumers who have a tolerance for advertising. In any event, measurement of the cost of any disutility would be difficult, and Mr. Orszag certainly did not attempt to do so. Additionally, by choosing an ad-supported service, as Dr. Leonard notes, listeners have revealed a preference (given their budget constraints and utility preferences¹⁷⁵) for that bundle of music + advertising over pure music priced at \$4.99 per month or more. And of course, an immediate problem with Mr. Orszag's assertion is that the payments of advertising revenues reflect the WTP of *advertisers* – not the WTP of *listeners*. (Again, Mr. Orszag does not attempt to convert listener time into a direct monetary measure.).

Further, advertising, like music, is an “experience” good. One does not know that certain advertising will be useful or not until it is heard. And in this context, it is important to appreciate that technological advancements in targeted advertising make it much more likely that advertising will be more useful to listeners than the former more blunderbuss approach.¹⁷⁶

¹⁷⁵ Economic jargon often obscures reality. “Budget constraints” refer to consumers’ limited incomes; for example, poor people will not have extra cash to spend on music, even if they would prefer the “utility” of an ad-free service, because they cannot transfer spending from necessities to the luxury of a subscription to a music service.

¹⁷⁶ The Judges do not endorse in full Pandora's criticism that the record companies should not receive royalties based on advertising revenues generated by Pandora's arguably superior advertising platform. As SoundExchange notes, noninteractive services, including Pandora, also benefit from the superior identification, development and promotion of sound recordings and artists. Moreover, the advertising revenue is derived from the presence of listeners, who are attracted to Pandora in large measure because of

All of these advertising-related concerns were not addressed in the record, and their absence makes Mr. Orszag's speculation regarding listeners' revelation of a positive WTP unpersuasive.

In order to distill value from advertising revenues, the Judges agree with Dr. Leonard that Mr. Orszag would have been better served if he had analyzed the ad-supported tier as a "multi-sided platform, where listeners, record companies and advertisers converge to create economic value for all participants. See Leonard WRT ¶ 54; 8/24/20 Tr. 3561 (Leonard) (describing advertising-supported services as "two-sided platform[s]" connecting users to advertisers and distinguishing them from subscription services for which there is no "other side of the market that you need to be worried about"); see generally DAVID S. EVANS & RICHARD SCHMALENSEE, MATCHMAKERS: THE

the music produced by the record companies. Therefore, the advertisers' demand, and Pandora's investments in better monetization of that advertiser demand, are derived in part from the attributes of, and investments in, the underlying sound recordings. It is more accurate to state that Pandora's advertising revenues are *jointly produced* as a consequence of what economist call a "joint production function," consisting of the quality of: (i) the record companies' music; (ii) Pandora's curation of the music; and (iii) Pandora's advertising platform. See 8/20/20 Tr. 3248 (Shapiro) ("the revenue earned [by Pandora's ad-supported service] is a combination of the music ... creating the experience, the person ... listening more, and then how much money can be collected per-play will depend also in an important way on value brought by the service [including] [Pandora's skill at monetization.>"). Additionally, the purpose of a rate setting process, whether by negotiating counterparties in an unregulated market or by the Judges, is to apply economic analysis to determine how the overall value of these inputs will be allocated as between licensors and licensees. Although each side of the licensing market can accurately claim that its investments are responsible for generating value, and that the other side is wrongly appropriating that value for itself, such self-serving claims do nothing to assist in the allocation of value and, hence, the setting of royalty rates. See generally Richard Watt, *Revenue Sharing as Compensation for Copyright Holders*, 8 REV. ECON. RES. COPYRIGHT ISSUES 51, 56 & n.8 (2011) (economically a royalty rate derived from a percent-of-revenue approach is analogous to an *ad valorem* tax on the service).

NEW ECONOMICS OF MULTISIDED PLATFORMS (2016); Ruth Towse, *Dealing with Digital: The Economic Organisation of Streamed Music*, 42 MEDIA CULTURE & SOCIETY, no. 7-8, 1461 (2020).¹⁷⁷

Additionally, the Judges find that the documents indicating that many Spotify subscribers originated as ad-supported listeners is uninformative. The Judges agree that the relevant measure is the extent to which ad-supported listeners convert to subscribers. Interestingly, that figure, [REDACTED]%, (as noted *supra*) is [REDACTED] to the 9.1% substitution figure from the Zauberman Survey (cited *supra*), which tends to confirm the low cross-elasticity between ad-supported and subscription tiers. Similarly, the internal Pandora documents on which SoundExchange relies do not [REDACTED], but rather purportedly estimate, [REDACTED].

In sum, the Judges find no sufficient basis to apply the benchmarking approach for the ad-supported noninteractive market that Mr. Orszag proffers in his WDT.¹⁷⁸

¹⁷⁷ Dr. Evans and Professor Schmalensee define a “multi-sided platform” as:

A business that operates in a physical or virtual place (a platform) to help two or more different groups find each other and interact. The different groups are called ‘sides.’ For example, Facebook operates a virtual place where friends can send and receive messages, where advertisers can reach users, and where people can use apps and app developers can provide those apps.

EVANS & SCHMALENSEE, *supra*, at 210. Professor Towse notes the particular application of multi-sided platform economics to the analysis of ad-supported music services. *Towse*, 42 Media Culture & Society, at 1465 (“In the streaming market, the upstream price is negotiated by the [Digital Service Provider] for the rights to stream the music ... for ad-based services, [it is] the price charged to the advertiser. *It is an obvious application of platform economics.*”) (emphasis added).

The Judges note that Mr. Orszag essentially endorses a platform-based approach in his WRT and hearing testimony, by acknowledging the appropriateness (in his model) of using revenue from the ad-supported service rather than subscription revenue. His testimony in that regard is discussed *infra*.

¹⁷⁸ The Judges’ rejection of Mr. Orszag’s ad-supported benchmark model moots any issues regarding his ad-supported benchmark adjustments.

d. Professor Shapiro's Ad-Supported Benchmark Model

Professor Shapiro's ad-supported benchmark comes from the *interactive* ad-supported market. According to Professor Shapiro, this is an appropriate and direct benchmark, consistent with *Web IV*, in which the Judges likewise used ad-supported benchmarks to develop the ad-supported statutory rate.¹⁷⁹

To apply this benchmark, Professor Shapiro begins by calculating weighted average *effective* per-play royalty rates. Specifically, he begins by analyzing the effective per-play rates paid by Spotify and SoundCloud¹⁸⁰ to the Majors for performances on their *ad-supported* interactive tiers from May 2018 through April 2019 – which he calculates as \$[REDACTED] per play. Shapiro WDT at 33, 36 & tbl.8; 8/19/20 Tr. 2900 (Shapiro). As discussed *supra*, although he includes SoundCloud data, essentially, the \$[REDACTED]. Shapiro WDT at 36 & tbl.8; 8/19/20 Tr. 2900 (Shapiro). Professor Shapiro further testifies that, to his knowledge, \$[REDACTED] was the [REDACTED] at that time. 8/19/20 Tr. 2900 (Shapiro).

More particularly, Professor Shapiro divides: (1) the total royalty fees paid by Spotify and SoundCloud to each Major between May 2018 and April 2019; by (2) the

¹⁷⁹ More particularly, in *Web IV*, the Judges relied on *noninteractive* ad-supported benchmarks: the Pandora/Merlin and iHeart/Warner agreements.

¹⁸⁰ It is undisputed that SoundCloud is not comparable to the target market services primarily because it has a high level of user-generated content and lacks access to the full catalogs of the record companies. 8/11/20 1408-09 (Orszag). Further, unlike other services, SoundCloud has always been mainly a platform where unsigned artists can post their music for downstream discovery. Harrison WDT ¶ 12; Trial Ex. 5289 at 7. The Services maintain that the issue regarding SoundCloud's suitability as a benchmark is "much ado about nothing," because [REDACTED], Services RPFCL ¶ 206, and Professor Shapiro notes that [REDACTED] 8/19/20 Tr. 2100 (Shapiro). Accordingly, the Judges do not rely on SoundCloud as an appropriate benchmark.

play counts on their ad-supported interactive tiers during the same period. Shapiro WDT at 36 & tbl.8, 63 (Appx. D).

Professor Shapiro includes in his (pre-adjustment) \$[REDACTED] per-play rate a previously omitted [REDACTED]. Shapiro WDT at 31 & Appx. D at 1. This [REDACTED] was needed because, pursuant to its contract with [REDACTED].¹⁸¹

In addition, Professor Shapiro includes in his (pre-adjustment) \$[REDACTED] per-play proposed rate a value for [REDACTED]. Professor Shapiro calculates this further value at \$[REDACTED] per play. Shapiro WDT at 33 n.47; Appx. D at 1-2 & n.4; *see also* Trial Ex. 4044 at 14, 43; Trial Ex. 5037 at 58-63 ([REDACTED]).

Before considering potential adjustments to his \$[REDACTED] benchmark rate that may be required to account for differences between the benchmark and target markets, Professor Shapiro characterizes this \$[REDACTED] per-play *interactive market* derived rate as exceeding an “upper bound for the zone of reasonableness” for ad-supported services. He reaches this opinion because he finds it would be “unreasonable for [noninteractive services] to pay more per-performance for streams of sound recordings than the rate ... for ... interactive performances,” which, because of its greater functionality, he characterizes as “far more valuable” than noninteractive performances). Shapiro WDT at 37.¹⁸²

¹⁸¹ However, Professor Shapiro declines to include a similar [REDACTED] payment by Spotify to Warner, asserting that the payment data he had been provided reflected a global true-up payment rather than a U.S. payment, without information to enable a break-out of the U.S. portion of the “true-up.” Shapiro WDT, app. D at 1 n.3; 8/19/20 Tr. 2911-12 (Shapiro). The Judges discuss the [REDACTED] issue *infra*.

¹⁸² To be clear, this benchmarking approach is *not* the ratio equivalency method. Because Professor Shapiro is applying effective noninteractive rates as his benchmarks, his model does not require an assumption of a particular level of substitution (cross-elasticity) between the benchmark and target markets that would affect the per-play rate in the target market.

i. Professor Shapiro's Adjustments

Professor Shapiro proposes the same three adjustments to his benchmark rate for ad-supported webcasters as he did for his subscription benchmark rate: (1) an interactivity adjustment; (2) a skips adjustment; and (3) an effective competition adjustment. Shapiro WDT at 37-40. He supports the application of all three adjustments on the same general bases he advocates for making these adjustments to his subscription benchmark, as discussed *supra*.

(A) Professor Shapiro's Proposed Interactivity Adjustment

Professor Shapiro proposes to make the same two-step adjustment he applies to the subscription benchmark. He relies on the principle he applies in the subscription market, *viz.*, that “the rights conferred to play music interactively ... are much more valuable than the rights conferred for statutory services” Shapiro WDT at 33-34. To make this adjustment – and even though Professor Shapiro eschews reliance on the ratio equivalency approach for this ad-supported benchmark – he proposes that his unadjusted \$[REDACTED] benchmark be reduced by 50% *by applying the same 2:1 “ratio equivalency” ratio that the Judges have only applied in connection with subscription services*. Shapiro WDT at 38-39. To apply this ratio adjustment in the ad-supported context, Professor Shapiro relies on the relative retail prices charged by ten leading *subscription* interactive services, \$9.99 per service, and three mid-tier services (offering limited interactivity), \$4.99 per service.¹⁸³ This adjustment reduces Professor Shapiro's benchmark rate from \$[REDACTED] to \$[REDACTED]. Shapiro WDT at 38-39.

Professor Shapiro testifies that he found further support for his 2:1 interactivity adjustment and the concomitant rate reduction to \$[REDACTED] by comparing: (1) the

¹⁸³ The services on which Professor Shapiro relies are the same as those he relied on to make this adjustment in the subscription market (Pandora Plus, Slacker LiveXLive Plus, and Napster unRadio).

rate Pandora pays Warner for limited Premium Access on-demand intervals on Pandora Free: \$[REDACTED]; with (2) the noninteractive rate Pandora pays Warner: \$[REDACTED] for noninteractive plays on its noninteractive tier. Trial. Exs. 5126, 4031; Shapiro WRT at 34. Similarly, Professor Shapiro notes that Pandora's contract with Sony contains a per-play royalty rate of \$[REDACTED] for noninteractive performances on its ad-supported noninteractive service, Trial. Exs. 5012 at 10; 5024 at 3, compared with a \$[REDACTED] rate for *interactive* plays on that same ad-supported noninteractive tier. Shapiro WRT at 34 n.93.

As he asserts regarding his proposed subscription benchmark interactivity adjustment, Professor Shapiro claims the above 2:1 adjustment remains insufficient because it compares the retail subscription price from the benchmark market to mid-tier services with *limited* interactive features – not to statutory *noninteractive* services. Shapiro WDT at 38. To complete the interactivity adjustment to account for this point, Professor Shapiro proposes (again, as with his subscription benchmark) to make an adjustment that reflects the percentage difference between: (1) the effective per-play mid-tier royalty rate for subscription services, \$[REDACTED]; and (2) the statutory rate paid by subscription noninteractive services: \$0.0023. Shapiro WDT at 30 & tbl.5, 38-39. This percentage difference is [REDACTED]%, based on a [REDACTED]:1 ratio of \$[REDACTED]:\$[REDACTED]. *Id.* Applying this [REDACTED]% adjustment on top of the 2:1 adjustment reduces Professor Shapiro's interim rate (before any other adjustments) from \$[REDACTED] to \$[REDACTED].

However, in an acknowledgement that Spotify's ad-supported mobile tier (a part of his benchmark service) is less than fully interactive, with functionality more like that of a mid-tier limited interactive service, Professor Shapiro testifies that it would be reasonable for the Judges to apply *only* his second interactivity adjustment—*i.e.*, the [REDACTED]:1 that he asserts adjusts for the difference between the value of (1) mid-

tier services; and (2) statutorily-compliant functionality. 8/19/20 Tr. 2905. Applying only this second interactivity adjustment, Professor Shapiro lowers his \$[REDACTED] per-play rate (described above) to \$[REDACTED] (subject to the additional adjustments detailed below).

(B) Professor Shapiro's Proposed Skips Adjustment

Professor Shapiro next proposes to make a skips adjustment, which he asserts is required because noninteractive licensees are required by statute to pay for plays under thirty seconds, but the benchmark interactive services do not pay for such truncated plays. Shapiro WDT at 39. Applying the same analysis as in his subscription benchmark model, and noting that recent Pandora data shows less-than-thirty second performances account for about [REDACTED]% of total radio performances, he derives a [REDACTED]:1 ratio for his skips adjustment. Shapiro WDT at 39. This adjustment lowers Professor Shapiro's benchmark rate for ad-supported services from \$[REDACTED] to \$[REDACTED] (applying both of his interactivity adjustments), or from \$[REDACTED] to \$[REDACTED] (applying only his second interactivity adjustment).

(C) Professor Shapiro's Proposed Effective Competition Adjustment

Professor Shapiro proposes the same effective competition adjustment here, as he did for his subscription benchmark. That is, he calculates the difference between the effective per-performance rates paid to the Majors by [REDACTED] interactive service (\$[REDACTED]) and the weighted average of the effective per-performance rates paid by ten other major on-demand streaming services (\$[REDACTED]). Shapiro WDT at 39-40, 42 & tbl.10. This results in a [REDACTED]:1 adjustment factor. This adjustment lowers Professor Shapiro's benchmark rate for advertising supported webcasters from \$[REDACTED] to \$[REDACTED] (if both interactivity adjustments are applied) or from

\$(REDACTED) to \$(REDACTED) (if only the second interactivity adjustment is made).

8/19/20 Tr. 2906-2907 (Shapiro).¹⁸⁴

As discussed in detail *supra*,¹⁸⁵ the Judges found that the 12% effective competition adjustment derived in *Web IV*—based on the pro-competitive effects of steering—remains the best measure, *ceteris paribus*, for transforming rates inflated by the Majors’ complementary oligopoly market power into effectively competitive rates. But, as also noted above, all other things were *not* equal (comparing the *Web IV* and *Web V* evidence) in the *subscription* benchmarking exercise, whereas here, the \$(REDACTED).¹⁸⁶

e. SoundExchange’s Criticisms of Professor Shapiro’s Ad-Supported Benchmark Model

i. Professor Shapiro’s Decision not to include the \$(REDACTED) Value

Professor Shapiro declines to apply a \$(REDACTED).¹⁸⁷ He explained in his WDT that, although he applies a \$(REDACTED), he declines to apply a *Warner* “true-up”

¹⁸⁴ The Judges consider Professor Shapiro’s proposed effective competition adjustment in light of (1) their finding that the 12% steering adjustment remains appropriate; and (2) SoundExchange’s criticism, discussed *infra*.

¹⁸⁵ See *supra*, section III.C

¹⁸⁶ See *supra*, section III.D

¹⁸⁷ A “true-up” in this context is an increase in total royalties paid at the end of the year. The additional royalties are due because, although \$(REDACTED)” See 9/3/20 Tr. 5668 (Harrison); Shapiro WDT at 31 n.47.

because it is his understanding that, although “[REDACTED].” Shapiro WDT at 63; Appx. D at 1 n.3 (emphasis added); *see also* 8/19/20 Tr. 2911-12 (Shapiro).¹⁸⁸

However, Mr. Orszag, in his WRT, asserts that Professor Shapiro should have made the [REDACTED]. Moreover, Mr. Orszag identified the document upon which he relies as supportive of this testimony. Orszag WRT ¶ 80 n.178 (identifying the royalty statement document as “SOUNDEX_W5_NATIVE_PROD_000751_RESTRICTED.xlsx.” (henceforth the “000751” document)).¹⁸⁹ SoundExchange had produced the “000751” document to the Services in discovery, and Professor Shapiro specifically identified it as one of the documents he reviewed in preparing his written testimony. Shapiro WDT, Appx. C; *see also id.* app. D at 1 & n.1 (identifying the documents on which Professor Shapiro relies to calculate ad-supported royalty payments as SOUNDEX_W5_NATIVE_PROD_000001-001558, a sequence that includes “000751,” the document identified by Mr. Orszag).

Professor Shapiro had an opportunity at the hearing to contest Mr. Orszag’s written rebuttal testimony in this regard, and, if he had contested that testimony, to explain why the aforementioned document was insufficient. Professor Shapiro did continue to claim at the hearing that [REDACTED]” *but he did not address Mr. Orszag’s assertion that the document the latter cited, the “00751” document, in fact* [REDACTED]. 8/19/20 Tr. 2911-12 (Shapiro) (Professor Shapiro asserting that he “[REDACTED]).

¹⁸⁸ The omission of this [REDACTED] is significant. When this royalty payment is included, Professor Shapiro’s (unadjusted) benchmark rate increases from approximately \$[REDACTED] to approximately \$[REDACTED]. *Compare* Orszag WRT tbl.8 with 8/19/20 Tr. 2912 (Shapiro) (describing the impact of applying or not applying the [REDACTED]).

¹⁸⁹ This document was not proffered as evidence at the hearing and, accordingly, is not part of the hearing record.

The Judges find Professor Shapiro’s failure to offer a substantive rebuttal relating to this document to be especially problematic because, as noted above, Professor Shapiro had already reviewed that document, had possession of it (or access to it) and presumably was familiar with its contents. Further, in its post-hearing proposed findings, the Services continue to ignore the “07751” document, asserting that “Mr. Orszag did not calculate the value of the true-up himself or provide the data required to do so.” Pandora/Sirius XM PFFCL ¶ 225. But, as noted above, Mr. Orszag did identify a document that he said contained the necessary data, and that specific testimony remained unchallenged.

It is also noteworthy that Google’s expert economic witness, Dr. Peterson, having access to the same data, decided to apply the [REDACTED] *in toto*. 8/25/20 Tr. 3780 (Peterson) [REDACTED]”); *see also* 8/10/20 Tr. 1172-73 (Orszag) (“Dr. Peterson and I have similarly found the same result”).

Professor Shapiro’s failure to challenge the sufficiency of the document identified by Mr. Orszag, combined with Dr. Peterson’s application of a [REDACTED] convinces the Judges that Professor Shapiro’s failure to apply a [REDACTED] was incorrect. Applying this [REDACTED] increases Professor Shapiro’s ad-supported benchmark rate, before any adjustments, from \$[REDACTED] to \$[REDACTED] (rounded). Orszag WRT tbls.7 & 8.¹⁹⁰

ii. Professor Shapiro’s Failure to Account for the Funneling (Conversion) Value of Spotify’s Ad-Supported Service

Mr. Orszag claims that a fundamental problem with Professor Shapiro’s use of the Spotify ad-supported tier as a benchmark is that he fails to account for the fact that this

¹⁹⁰ Mr. Orszag, like Professor Shapiro, includes in his calculation of the Spotify effective rate the value of marketing considerations (alternatively valued at the functionally equivalent rate \$[REDACTED] per-play) in the agreements between Spotify and major record companies. *Compare* Shapiro WDT at 31 n.47 & app. D at 2 *with* Orszag WRT tbls. 7 & 8.

benchmark also incorporates a successful and thus valuable feature: the ability to convert users to Spotify's more lucrative subscription tier. Orszag WRT ¶ 72.

SoundExchange notes that, at the hearing, Professor Shapiro acknowledges this point. First, as a general matter, he agreed that the more promotional a music service is of other revenue streams (net of substitution for other revenue streams, the lower the royalty rate the service should be able to negotiate. Then, specifically, Professor Shapiro admitted that, if [REDACTED], then [REDACTED] 8/19/20 Tr. 2967 (Shapiro).

Mr. Orszag further explains that the importance of funneling ad-supported users into paid subscriptions is thus a [REDACTED] component of the bargain between the record companies and Spotify. That value is manifested in the parties' negotiations by the record companies' [REDACTED]. Orszag WRT ¶ 73.

Another SoundExchange economic witness, Professor Tucker, places Spotify's funneling/conversion value in the broader contemporary economic context of "freemium" pricing models. More particularly, she notes the need for sellers to experiment constantly with different ways of "nudging people to upgrade" and reminding them of the potential benefits of the premium paid product, "so as to overcome the risk that customers will become "anchored to a zero price." 8/17/20 Tr. 2116 (Tucker). Professor Tucker opined that the record companies' [REDACTED] was a striking application of the commercial necessity to funnel and convert to a premium service. *Id.* at 2120-21. (Tucker).

The Services contend that SoundExchange has failed to demonstrate adequately the [REDACTED]. Also, they contend record company witnesses have indicated that, notwithstanding any discounts/penalties based on listener tenure, the record companies have [REDACTED] Services RPFCL ¶¶ 179-183 (and record citations therein).

Notwithstanding these rejoinders, the Services propose that, if the Judges find Spotify's ad-supported tier rates to include [REDACTED], rather than reject the ad-supported rates as benchmarks, the Judges should adjust the Spotify ad-supported

benchmark rate upwards in an attempt to isolate and remove the [REDACTED] in that rate tier. *See* 8/19/20 Tr. 2912 (Shapiro). In that regard, Professor Shapiro agreed that other potential evidence exists to calculate this adjustment: the express terms in [REDACTED] 8/19/20 Tr. 2912-13, 2914 (Shapiro) (agreeing with Judge Strickler's suggestion that the [REDACTED]); *see generally* Services PFFCL ¶ 146; Pandora/Sirius XM PFFCL ¶¶ 242-243 (and record citations therein).

The Judges find that, despite the various incentives and market power that may have led to the [REDACTED],¹⁹¹ the [REDACTED], serve as a useful basis by which to isolate the [REDACTED]. Indeed, as discussed at length *infra*, the parties have adopted a basis by which to apply these [REDACTED].

Having considered SoundExchange's criticisms of Professor Shapiro's establishment of a benchmark, the Judges next proceed to a consideration of SoundExchange's criticisms of the potential adjustments proffered by Professor Shapiro.

iii. Criticism of Professor Shapiro's Interactivity Adjustment

Taking on Professor Shapiro's first interactivity adjustment, SoundExchange challenges the correctness of applying a supposed value for interactivity derived from the subscription market in the ad-supported market. More particularly, SoundExchange asserts, relying on Professor Shapiro's own testimony, that the added value, if any, of interactive functionality depends on its value *to consumers* in the downstream market. In a subscription market, SoundExchange avers the service's demand for interactive functionality is a derived demand, arising from its downstream customers' WTP for

¹⁹¹ Any potential impact from differences in market or bargaining power, such as from the licensors' complementary oligopoly market structure, Spotify's unique position as a pureplay service, interactivity differences or play counts, is addressed by the Judges elsewhere in this Determination, both generally and with specific regard to the experts' rate proposals.

interactive functionality. SX RPFCL (to Pandora/Sirius XM) ¶ 229 (citing 8/19/20 Tr. 2975-76 (Shapiro)).

In contrast to a subscription market, SoundExchange maintains, an ad-supported service's demand for interactive functionality would be irrelevant to the calculation of advertisers' WTP for advertisements, and the users' willingness to listen to them. *Id.* (citing 8/19/20 Tr. 2977-80 (Shapiro)). Thus, SoundExchange maintains that Professor Shapiro errs in using an interactivity adjustment derived from the subscription market to adjust his ad-supported rates. In further support of this argument, SoundExchange relies on the testimony of two of the Services' economists, testifying for the NAB and Google, respectively, in this proceeding. *Id.* (citing Leonard WRT ¶ 54 ("[T]he relationship between revenue generation and interactivity is substantially different for ad-supported than for subscription services."); and 8/25/20 Tr. 3702-03 (Peterson) ("[I]t's really the willingness to pay of advertisers and the ability of the service to attract advertisers that is going to affect the revenue on the service. It's not listeners that are providing that revenue.")).

Turning to Professor Shapiro's second interactivity adjustment based on mid-tier subscription services, SoundExchange offers the same criticism as it asserts immediately above because this adjustment is also derived from the subscription market. SX RPFCL (to Pandora/Sirius XM) ¶ 230. SoundExchange also raises the criticism of this second interactivity adjustment it makes in connection with Professor Shapiro's subscription benchmark adjustments. That is, SoundExchange re-asserts that Professor Shapiro: (1) entirely ignores consumer WTP to pay in the downstream market by relying on upstream royalty differentials; (2) cannot cite to evidence any positive WTP of consumers in the downstream market for the additional functionality that Pandora obtained for its mid-tier Pandora Plus service; (3) wrongly dismisses the fact that the subscription price for Pandora's prior noninteractive service was the same (\$4.99) as its subsequent mid-tier

Pandora Plus service; (4) merely speculates that the additional functionality of Pandora Plus may have increased consumer demand compared to demand for its prior noninteractive service; (5) ignores the fact that any increase in subscribership that may have occurred simply adds more plays and more revenue, without necessarily changing revenue per play; (6) fails to address the fact that [REDACTED] and (7) wrongly uses a statutory rate (the \$0.0023 rate) as his base against which to compute the percentage value added by Pandora's mid-tier service. *See* SX PFFCL ¶¶ 143-156 (and record citations therein).

SoundExchange also takes issue with the implicit premise that Spotify's ad-supported service has the full functionality necessary to justify the interactivity adjustments Professor Shapiro proposes. It notes that (as Professor Shapiro himself acknowledges), although Spotify's ad-supported service is fully interactive when used on a desktop, its mobile service is not fully interactive, but rather provides a "shuffle" feature that lets listeners select an artist or playlist and hear a somewhat randomized stream of tracks by that artist or from that playlist. *See* 8/19/20 Tr. 2985 (Shapiro).¹⁹² However, SoundExchange notes that Professor Shapiro does not reduce his proposed interactivity adjustment to reflect the lower functionality of the mobile service, 8/19/20 Tr. 2986 (Shapiro), even though he acknowledges that "[REDACTED]" and its [REDACTED] 8/19/20 Tr. 2986-87 (Shapiro).¹⁹³

¹⁹² Spotify's mobile shuffle service also allows up to 6 songs from an album within a 60 minute period, compared to the statutory sound recording performance complement which allows only 3 songs from an album within a 3 hour period. *See* Peterson WDT ¶ 45 n.33.

¹⁹³ It was for this reason that Professor Shapiro proposes the alternative interactivity adjustment approach, as discussed *supra*, whereby only the difference between the mid-tier royalty rate and the statutory rate (his "second" interactivity adjustment) would be applied. However, SoundExchange characterizes this approach as a "tactical retreat" without economic meaning, because Professor Shapiro offers no

SoundExchange also takes issue with Professor Shapiro's reliance on the per-play rates of \$[REDACTED] for Premium Access plays on Pandora's noninteractive service. It notes that, for example, Sony's contract with [REDACTED]" Trial Ex. 5097 at 1. Accordingly, SoundExchange maintains that these per-play rates embody a promotional value, and thus do not reflect the stand-alone value of on-demand functionality on Pandora's ad-supported service.

iv. Criticism of Professor Shapiro's "Skips" Adjustment

SoundExchange questions the probative value of the data upon which Professor Shapiro relies for his [REDACTED]% skips adjustment on the same basis as it challenges his application of this data to his skips adjustment in the subscription market. To recap the criticism, SoundExchange notes that Professor Shapiro acknowledges that this data came from noninteractive plays available on all three tiers of Pandora's service – ad-supported, mid-tier and fully interactive. 8/20/20 Tr. 3028-29 (Shapiro). As a consequence, Mr. Orszag asserts, the [REDACTED]% "skips" rate is likely overstated because subscribers to Pandora's two interactive tiers have unlimited skips, making them more likely to skip when accessing noninteractive plays on those two tiers. Orszag WRT ¶ 120. SoundExchange notes that Professor Shapiro agrees but testifies that any such upward bias would have had a *de minimis* impact, so he did not measure the effect. 8/20/20 Tr. 3030-32 (Shapiro).

explanation for why an interactivity adjustment for a mid-tier subscription service—with the same functionality available on *both* desktop and mobile devices—is applicable to Spotify's ad-supported service (with functionality that differs depending on whether the music is delivered via a mobile or a desktop method). SX RPFCL (to Pandora/Sirius XM) ¶ 233.

v. Criticisms of Professor Shapiro's Effective Competition

Adjustment

SoundExchange asserts that no effective competition adjustment is warranted. Because Professor Shapiro proffers the same [REDACTED]% effective competition adjustment to the ad-supported rate as he does to the subscription rate, for the same reasons, SoundExchange sets forth the same substantive opposition. *See* SX PFFCL ¶¶ 487-489. Accordingly, the Judges' recitation of that argument *supra* is incorporated by reference here.¹⁹⁴

SoundExchange also repeats its argument regarding the virtual equivalency of the \$[REDACTED] effective per-play rate for [REDACTED] and the \$[REDACTED] effective per-play rate for Spotify. Again, SoundExchange notes that Professor Shapiro characterizes this [REDACTED] rate as effectively competitive, whereas he asserts that [REDACTED] reflects the Majors' complementary oligopoly power. *See* SX PFFCL ¶¶ 483-486 (and record citations therein).

f. The Judges' Analysis and Findings regarding Professor Shapiro's Proposed Adjustments

i. Professor Shapiro's Proposed First and Second Interactivity Adjustments

The Judges reject Professor Shapiro's proposed interactivity adjustments to his proposed ad-supported rate. In reaching this finding, the Judges agree with SoundExchange that the concept of added economic value for interactivity is not a suitable basis to adjust downward a proposed benchmark rate. Advertisers, not listeners, pay the royalties. And there is insufficient evidence to establish that advertisers' payments to noninteractive ad-supported services are a function of the level of

¹⁹⁴ *See supra*, section IV.B.1.e.v(C).

interactivity of that service.¹⁹⁵ Moreover, Professor Shapiro's attempt to apply the 2:1 interactivity adjustment derived from the subscription market is not only unsupported, it is ironic, because Professor Shapiro has rightfully chastised Mr. Orszag for applying subscription market data to divine an ad-supported rate, as discussed *supra*.

The Judges also decline to endorse Professor Shapiro's alternative proposal to apply only his second interactivity adjustment. As the Judges explained *supra* regarding Professor Shapiro's proffer of this [REDACTED]% adjustment in the subscription market, there is no sufficient evidentiary basis to use the *entirety* of the upstream royalty differences to generate downstream differences in interactivity value, nor is there sufficient evidence that *any* of the royalty difference (\$[REDACTED]) reflected actual value differences, given the \$4.99/month price for both Pandora's prior Pandora One statutory subscription service and its subsequent Pandora Plus mid-tier subscription service. Moreover, because this royalty differential relates to the subscription market, the Judges find it (like professor Shapiro's proffered first interactivity adjustment) to be uninformative with regard to the ad-supported market.

ii. Professor Shapiro's Proposed Skips Adjustment

SoundExchange does not add any other criticisms of Professor Shapiro's skips adjustment to its discussion of his ad-supported adjustment to his subscription skips adjustment. Accordingly, the Judges adopt (and incorporate by reference here) the same analysis and the same finding of a [REDACTED]% skips adjustment as they found for the subscription market.

¹⁹⁵ To be sure, listeners to ad-supported services may well prefer interactive functionality to noninteractive functionality, because the former provides greater utility. The problem is that such a preference is not revealed in this multi-sided platform context because the listeners do not make purchasing decisions.

iii. Professor Shapiro's Proposed Effective Competition Adjustment

Because Professor Shapiro's proffered ad-supported effective competition adjustment, and SoundExchange's criticism thereof, are identical to their positions regarding this potential adjustment in the subscription market, the Judges incorporate by reference here their rejection of that adjustment, and the reasons for that rejection.¹⁹⁶

The Judges' rejection of Professor Shapiro's proposed effective competition adjustment does not mean that no such adjustment is warranted. Rather, the Judges apply the same analysis to the ad-supported sector as they have in the subscription context. However, the Judges' *application* of that approach here in the ad-supported sector differs from their analysis in the subscription sector. To recap, in the subscription sector, [REDACTED].¹⁹⁷ Thus, when applying the [REDACTED]% effective competition adjustment based on the price-competitive impact of steering, the Judges offset the percentage difference between the [REDACTED]% and [REDACTED]% rates – [REDACTED]% – to set an effective competition adjustment of [REDACTED]% (*i.e.*, [REDACTED]% - [REDACTED]%).

¹⁹⁶ See *supra*, section IV.B.1.e.v(C). The Judges add, though, that Professor Shapiro's ad-supported methodology appears to shed light on Pandora's decision (discussed *supra*) to propose an effective competition adjustment ([REDACTED]%) based on the difference between the interactive average royalty rate (\$[REDACTED]) and the [REDACTED] royalty rate (\$[REDACTED]), rather than the difference between the \$[REDACTED] average rate and [REDACTED]'s \$[REDACTED] effective per-play rate. *Because Pandora uses the Spotify ad-supported rate as its benchmark, if it identified Spotify's effective per-play rate (based on a [REDACTED]) as effectively competitive, it could not then rely on that rate to generate a downward effective competition adjustment, as exposed by SoundExchange.* That would have significantly increased Pandora's proposed benchmark rate.

¹⁹⁷ Under the 2017 Agreements, [REDACTED]. Shapiro WDT at 40, tbl.10; see also Orszag WDT ¶ 153 & tbl.15 ([REDACTED]).

However, in the ad-supported sector, [REDACTED]. Indeed, the Majors [REDACTED]. Ultimately, the Majors and Spotify [REDACTED]. Trial Ex. 4040 (Universal/Spotify 2017 Agreement); Trial Ex. 5038 (Warner/Spotify Agreement).

With regard to the headline per-play rates, the 2017 Universal-Spotify Agreement [REDACTED]. *Compare* Trial Ex. 2062, Fees Annex, p. 3 (2013 Agreement) *with* Trial Ex. 4040, Fees Annex, p.1 of 3; *see also* Harrison WDT ¶ 24 (noting [REDACTED]); Shapiro WRT at 19 n.60 ([REDACTED]). Similarly, [REDACTED]. *Compare* Trial Ex. 5020 ex. I (Rate Card) (2013 Agreement) *with* Trial Ex. 5038 app. 1 (Rate Card) (2017 Agreement).¹⁹⁸

In the other tier of its 2017 Agreements with [REDACTED], Spotify [REDACTED]. Spotify has been paying royalties [REDACTED] 2017 Agreements because that [REDACTED]. 8/20/20 Tr. 3085-86 (Shapiro); 8/11/20 Tr. 1233 (Orszag). But, as Mr. Harrison of Universal acknowledged, [REDACTED]. 9/3/2020 Tr. 5710-11 (Harrison); SX PFFCL ¶ 291 (acknowledging the [REDACTED]). Further, there is no evidence to indicate that the effective per-play rate on the ad-supported tier [REDACTED] under Spotify's 2017 Agreements with the other two Majors, *i.e.*, Warner or Sony.

Mr. Harrison asserts that the reason Spotify's [REDACTED] was because Spotify was [REDACTED]. But the ability of a licensor to extract value from a licensee's [REDACTED] is precisely the sort of "heads-I-win, tails-you-lose" advantage that the Judges noted in *SDARS III* is part-and-parcel of a licensor's complementary oligopoly power. *SDARS III*, 83 FR at 65228. Accordingly, the 2017 Agreement between Universal and Spotify, with regard to the ad-supported rates (and unlike with regard to

¹⁹⁸ The Sony/Spotify 2013 and 2017 Agreements [REDACTED]. *See* Trial Exs. 5074 (2013 Agreement) and 5011 (2017 Agreement); *see also* Orszag WDT, fig.6..

the subscription rates), is consistent with an undiminished exercise of complementary oligopoly power.¹⁹⁹

Additionally, by obtaining [REDACTED] in the 2017 Agreements, Universal and Warner [REDACTED], relative to their 2013 Agreements, [REDACTED]. Thus, [REDACTED] of the 2017 Agreements, these Majors had [REDACTED]— which, as noted above, [REDACTED], according to Mr. Harrison.

The Judges find these facts to belie any assertion that [REDACTED]. Thus, the effective competition adjustment on the ad-supported tier remains at [REDACTED]%, as it pertains to Professor Shapiro’s benchmark rate.

g. Applying the Skips and Effective Competition Adjustments

Because the Judges do not apply any interactivity adjustment to Professor Shapiro’s ad-supported benchmark rate, they adjust the \$[REDACTED] per-play ad-supported rate by first applying the [REDACTED]% adjustment for skips, which reduces the rate to \$[REDACTED]. The Judges then apply the effective competition adjustment of [REDACTED]. The resulting rate is \$[REDACTED] (\$[REDACTED]) rounded).

¹⁹⁹ The Judges discussed this phenomenon elsewhere in this Determination, regarding the Majors’ obtaining a share of the value of Pandora’s investment in the monetization of its advertising platform. In that context and in the present context, the extent to which the Majors can share in the increase in advertising revenue is a function of their complementary oligopoly power (as is every aspect of the rate-setting process). This *particular* aspect of the Majors’ complementary oligopoly power is mitigated by the Judges’ *general* inclusion of the [REDACTED]% effective competition adjustment, which is broadly intended to offset all aspects of the Majors’ complementary oligopoly power (that is not otherwise offset by Spotify’s countervailing power in the subscription benchmark market).

3. Supplementation by Mr. Orszag and Professor Shapiro to their Original Ad-Supported Benchmarking Approaches

Both Mr. Orszag and Professor Shapiro supplement their ad-supported benchmarking models in manners that narrow the differences between their proposed rates. Each expert's supplemental position is examined *seriatim* below.

a. Professor Shapiro Acknowledges the Propriety of Adjusting his Proposed Spotify Ad-Supported Benchmark Rate Higher to Account for Spotify's Ability to Funnel Ad-Supported Users into its Higher Royalty-Bearing Subscription Tier

Professor Shapiro takes notice of SoundExchange's criticism that his ad-supported benchmark model fails to account for Spotify's added value as a funneling tool, converting ad-supported listeners into subscribers who pay a higher retail price and generate higher royalties. 8/19/20 Tr. 2912 (Shapiro) ("[[REDACTED]]"); *see also* Orszag WRT ¶ 72. Further, for benchmarking purposes in this proceeding, Pandora assumes that [REDACTED] a value to the Majors that [REDACTED]. Pandora/Sirius XM PFFCL ¶ 241.²⁰⁰

Having adopted this assumption, Professor Shapiro testifies that the appropriate response is not to disregard Spotify's ad-supported tier rates. Rather, the correct approach is to address Spotify's ad-supported rate structure by [REDACTED]. 8/19/20 Tr. 2912 (Shapiro); Shapiro WRT at 42.

Taking note of the aforementioned Spotify agreements with Warner and Universal, Professor Shapiro focuses on the per-play royalty rates Spotify pays

²⁰⁰ Consistent with this assumption, the Judges have described *supra* the ad-supported rate structure in Spotify's agreements with Universal and Warner, respectively, that provide Spotify [REDACTED].

[REDACTED]): \$[REDACTED].²⁰¹ Each of these rates, Professor Shapiro notes, represents a [REDACTED]% [REDACTED] the base per-play minimum specified in the agreements. Shapiro WRT at 43; Harrison WDT ¶ 67 (regarding the Universal agreement); Adadevoh WDT ¶ 21 (regarding the Warner Agreement).

According to Professor Shapiro, it would be appropriate to use the [REDACTED]users, as the basis for an upward adjustment to his benchmark rate, in order to [REDACTED]. In other words, [REDACTED]. 8/19/20 Tr. 2912-14 (Shapiro).

Professor Shapiro at first intended to adjust his benchmark rate higher to reflect the full [REDACTED]% [REDACTED]. However, Mr. Orszag pointed to a fact that indicated Professor Shapiro would actually *overstate* his benchmark if he applied [REDACTED]. Specifically, Mr. Orszag testified:

You just can't take the rate and [REDACTED]. That would be inappropriate. One would want to weight by the number of subscribers who have been—have been [REDACTED] [REDACTED].

8/11/20 Tr. 1382 (Orszag). Mr. Orszag used this data to determine that, to adjust the proposed royalty rate derived by Professor Shapiro (and by Dr. Peterson), as well as the proposed royalty rates he derived – to eliminate the funneling/conversion value in the rate structure – required a [REDACTED] adjustment (a [REDACTED]) in their respective rates. 8/11/20 Tr. 1382, 1405-06 (Orszag); 8/25/20 Tr. 3816 (Orszag).²⁰²

²⁰¹ There is no evidence of a comparable [REDACTED] rate in its agreement with Sony.

²⁰² Mr. Orszag calculated this [REDACTED] adjustment from a worksheet he utilized in this proceeding that had been produced by SoundExchange to the Services in discovery, Bates #W5 00492-00502).

8/11/20 Tr. 1408 (Orszag) (promising to identify the underlying worksheet the next hearing day); 8/12/20 Tr. 1486 (identification of the worksheet the next hearing day by David Handzo, Esq., counsel for SoundExchange, without objection).

Professor Shapiro analyzed this background worksheet and came to the same conclusion as Mr. Orszag, quantifying the smaller upward adjustment of [REDACTED]% to the proposed rate, rather than [REDACTED]%. *Compare* 8/25/20 Tr. 3816 (Orszag) (“Professor Shapiro in his testimony has introduced a new adjustment. He proposed a [REDACTED] × adjustment to the Spotify Free rate ... that works to correct the [REDACTED] that are associated with the Spotify Free benchmark. And with that, *I am more comfortable with that benchmark.*”) with 8/19/20 Tr. 2913, 2921, 2970 (Shapiro) (“I have calculated, for the same calculation he did ... that the proper adjustment would be a [REDACTED] adjustment factor.... [W]e did the same calculation and we both got to this same number.... And that ratio is also [REDACTED]. So we're doing the same thing.... I [had] said something like the [REDACTED], but Mr. Orszag corrected me and pointed out it should be [REDACTED].”).

Applying this [REDACTED] factor to the Judges’ calculation (conducted *supra*) of Professor Shapiro’s benchmark effective rate for ad-supported noninteractive services, \$[REDACTED], results in a final effective rate of \$[REDACTED] (*i.e.*, \$[REDACTED] × [REDACTED]), or **\$0.0023** (rounded).

b. Mr. Orszag Acknowledges the Propriety of Using Spotify’s Ad-Supported Service as a Benchmark for the Statutory Benchmark Service

Although SoundExchange and Mr. Orszag continue to advocate for the latter’s *subscription benchmark-based rate* of \$0.0025 as the statutory ad-supported rate,²⁰³ Mr. Orszag subsequently testified that he had become “comfortable” as well with applying Spotify’s *ad-supported rate* as the benchmark in his own ratio equivalency model. He

²⁰³ “I continue to believe that license agreements for subscription on-demand services can be useful benchmarks for statutory ad-supported services.” Orszag WRT ¶ 75.

came to this conclusion after discerning that “[t]he percentage of revenue for the Spotify subscription tier is virtually the same as the percentage of revenue for the Spotify Free tier.” 8/25/20 Tr. 3809 (Orszag).

More particularly, he notes that the effective percent-of-revenue rate paid by [REDACTED] (*i.e.*, as a percent of advertising revenue) is [REDACTED]%. Peterson WDT, ¶ 51. By comparison, the royalty rate on which Mr. Orszag relies in his WDT is based on a very similar [REDACTED]% subscription market effective rate paid by [REDACTED]. Orszag WDT, tbls.7, 9.

Mr. Orszag notes, though, that his percent of revenue calculation differs from the calculations of Dr. Peterson and Professor Shapiro. Dr. Peterson bases his royalty percentage on net revenue, which is lower than gross revenue. By contrast, Mr. Orszag makes his percent-of-revenue calculation off Spotify’s gross revenues. The revenue figure (whether gross or net) is the denominator in the calculation of effective percent-of-revenue royalties. (The royalties paid comprise the numerator.). Thus, Dr. Peterson’s [REDACTED]% figure, Mr. Orszag acknowledges, must be restated using gross revenues, to make an apples-to-apples comparison with Mr. Orszag’s benchmarking approach. Mr. Orszag performs this restatement and re-calculates Spotify’s effective percent-of-revenue royalty payments, on a gross revenue basis, as [REDACTED]%. Orszag WRT ¶ 71 n.155. Mr. Orszag also notes that the effective percent-of-revenue rate (apparently on gross revenues) determined through Professor Shapiro’s data is similar, at [REDACTED]% (after correcting for (1) Professor Shapiro’s acknowledged double-counting in connection with the [REDACTED]) and (2) his decision not to provide [REDACTED].). Orszag WRT ¶ 71 nn.155-156.

Mr. Orszag explains that, when establishing percent-of revenue rates using net advertising revenues, his own ratio equivalency approach (*not* the benchmarking approach of either Dr. Peterson or Professor Shapiro) per-play rates decrease by

[REDACTED]%, from \$[REDACTED] to \$[REDACTED] (a \$[REDACTED] reduction). *Id.*²⁰⁴ Specifically, when Mr. Orszag applies Dr. Peterson’s [REDACTED]% of revenue figure, Mr. Orszag calculates a per-play royalty of \$[REDACTED] (\$[REDACTED] rounded). Similarly, when Mr. Orszag applies Professor Shapiro’s [REDACTED]% rate, Mr. Orszag calculates an effective per-play rate of \$[REDACTED] (which also rounds to \$[REDACTED])). Orszag WRT ¶ 71 n.156.

In his WRT, Mr. Orszag continues to cast doubt, though, on Spotify’s ad-supported rate as a useful benchmark. He emphasizes that Spotify’s ad-supported tier is “wholly different” from, *inter alia*, statutory noninteractive ad-supported services because of the former’s separate attribute as a [REDACTED] funneling tool, inducing ad-supported listeners to convert to subscribership and its concomitant higher royalty payments. Orszag WRT ¶¶ 72-75. However, as noted *supra*, when the [REDACTED] adjustment was made to control for the separate value of funneling/conversion,²⁰⁵ Mr.

²⁰⁴ To be clear, Mr. Orszag is here plugging in calculations of percent-of-revenue rates in the benchmark market by using Dr. Peterson’s and Professor Shapiro’s own percent-of-revenue calculations in order to generate a percent-of-revenue rate in the benchmark market that Mr. Orszag, *using his ratio equivalency model*, then applies to the target market; Mr. Orszag is *not* applying his percent-of-revenue calculations, as derived from these other two experts, in *their benchmarking models*. See Services PFFCL ¶¶ 48-56 (and record citations therein).

²⁰⁵ Mr. Orszag also contends that the [REDACTED] rate is still too low because: (1) some Spotify ad-supported listeners ultimately convert to the subscription tier [REDACTED]; and (2) Spotify’s contract with the Majors require it to [REDACTED]. Orszag WRT ¶¶ 73, 75 n.167. However, the Services convincingly note that: (1) [REDACTED]; and (2) there is no evidence that [REDACTED], resulting in a loss of revenue. Services RPFCL ¶¶ 195, 204; *see also* 8/19/20 Tr. 2971 (Shapiro) (noting that an adjustment based on additional revenue arising from an [REDACTED]).”).

Orszag became, if not a full-fledged convert, “more comfortable” with the “Spotify Free benchmark.” 8/25/20 Tr. 3816 (Orszag).²⁰⁶

When Mr. Orszag applies the [REDACTED] adjustment to reflect the number of Spotify listeners [REDACTED], his proposed rate – derived from his ratio equivalency model but using Spotify’s ad-supported data – increases from \$[REDACTED] to \$[REDACTED] See 8/11/20 Tr. 1406 (Orszag).

The final step in this analysis would be to apply an appropriate adjustment for effective competition. For the reasons discussed, *supra*, regarding the effective competition adjustment necessary for Professor Shapiro’s ad-supported benchmark rate, the Judges apply the same 12% effective competition adjustment.

Applying the 12% effective competition adjustment to Mr. Orszag’s \$[REDACTED] rate reduces his ad-supported rate, to \$[REDACTED] (**\$0.0024** rounded).

As in the subscription market analysis, the Judges need to weight the relative impacts of: (1) the benchmark approach of Professor Shapiro (joined in the ad-supported analysis by the identical rate identified by the Judges from Dr. Peterson’s analysis) and (2) Mr. Orszag’s (*de facto*) ratio equivalency approach. The Judges use the same approach here as they did *supra* for the subscription rate. That is, they look to the

²⁰⁶ The Services nonetheless do not agree with the methodology utilized by Mr. Orszag, as it does not reflect the need to make any appropriate adjustments. *Id.*; Pandora/Sirius XM PFFCL ¶ 244 n.33.

However, the Judges examine the relative merits of the Services’ proposed adjustments separately, in their analysis of each expert’s model. The salient point here though is that Professor Shapiro’s approach (and Dr. Peterson’s approach) yield effective per-play royalty rates on the ad-supported tiers that are quite proximate, prior to the consideration of particular adjustments.

Zauberman Survey,²⁰⁷ as applied by Professor Willig, for SoundExchange's estimate of the diversion ratio from ad-supported *noninteractive* listeners to a new ad-supported *interactive* service, which is [REDACTED]%.²⁰⁸

Thus, Mr. Orszag's \$0.0024 rate has a weight of [REDACTED]% in the calculation of the overall benchmark rate in the ad-supported market. Professor Shapiro's \$0.0023 rate has a weight of [REDACTED]% (*i.e.*, 1- [REDACTED]). The resulting rate is **\$0.0023** (rounded).²⁰⁹

4. Dr. Peterson's Ad-Supported Benchmark Model

a. Dr. Peterson's Interactive Benchmark

Dr. Peterson, testifying on behalf of Google, derived his ad-supported benchmark analysis from the *interactive* ad-supported market. According to Dr. Peterson, this is an appropriate benchmark, consistent with *Web IV*, in which the Judges used ad-supported benchmarks to develop the ad-supported statutory rate. 8/25/20 Tr. 3631 (Peterson); Peterson WDT ¶¶ 10, 12. Google and Dr. Peterson posit that Spotify's ad-supported service is the closest benchmark available for statutory ad-supported services. Google LLC's Amended Proposed Findings of Fact and Conclusion of Law ¶ 24 (Google

²⁰⁷ As the Judges noted regarding their use of the Zauberman Survey in their subscription rate calculation, although they find the Zauberman Survey less reliable in other respects than other surveys in the record, only the Zauberman Survey asks respondents directly the necessary diversion question, here, to identify the source of music to which they would divert if noninteractive ad-supported services were not available, not if they were merely downgraded.

²⁰⁸ Professor Willig estimated the number of monthly plays on Pandora to be [REDACTED]. Willig WDT ¶ 45. The diversion of monthly plays to interactive ad-supported services (*i.e.*, to a service such as Spotify's) is [REDACTED], according to Professor Willig's application of the Zauberman Survey. Willig WDT, fig.6 (panel A). [REDACTED]=[REDACTED]% (rounded).

²⁰⁹ [REDACTED].

PFFCL); 8/25/20 Tr. 3633-34 (Peterson). Google further suggests that the Judges have indicated a preference toward benchmark analysis and that prior determinations have tended to eschew non-benchmark-based approaches. Google PFFCL ¶¶ 13-18; *Web IV*, 81 FR at 26320, 26327; *Distribution of Cable Royalty Funds*, Final Allocation Determination, 84 FR 3352, 3602 (Feb. 12, 2019) (*2010-13 Cable Allocation Determination*).

To apply his benchmark, Dr. Peterson began by calculating effective per-play royalty rates, derived from the royalties paid by Spotify to Warner, UMG, Sony, Merlin and Ingrooves on a percent-of-revenue [REDACTED], in which the other [REDACTED]. Peterson WDT ¶¶ 10, 48-51; 8/25/20 Tr. 3634 (Peterson) (explaining that he divided the total royalties paid or to be paid by the reported royalty-bearing plays for each label); Peterson WDT ¶¶ 13, 48.²¹⁰ Dr. Peterson used the payments due under the [REDACTED]. 8/25/20 Tr. 3636-3637 (Peterson) ([REDACTED]). Under the Spotify licenses, Dr. Peterson found that the effective per-play rates [REDACTED]. Peterson WDT ¶¶ 10, 48-51.

On behalf of SoundExchange, Mr. Orszag, as noted *supra*, proposed that an upward adjustment was necessary to address the funneling/conversion value

²¹⁰ Dr. Peterson also analyzed SoundCloud Limited's (SoundCloud) licenses with UMG and Warner for the SoundCloud ad-supported tier to corroborate his findings based on the five Spotify licenses. The SoundCloud licenses were offered as confirmatory benchmarks rather than primary benchmarks because the SoundCloud ad-supported tier includes comparatively less than a full catalog of content and significant user-generated content. Peterson WDT ¶ 11. As previously indicated, the Judges find that SoundCloud is not comparable to the target market services primarily because it has a high level of user-generated content and lacks access to the full catalogs of the record companies. 8/11/20 1408-09 (Orszag). Further, unlike other services, SoundCloud has always been mainly a platform where unsigned artists can post their music for downstream discovery. Harrison WDT ¶ 12; Trial Ex. 5289 at 7.

[REDACTED], namely a [REDACTED] adjustment (a [REDACTED]% increase) in the respective rates. 8/11/20 Tr. 1382, 1405-06 (Orszag); 8/25/20 Tr. 3816 (Orszag).²¹¹ Dr. Peterson set forth that any adjustment to Spotify ad-supported rates to account for value attributable to funneling or conversion of users from ad-supported to paid subscription tiers that may occur should not look toward funneling occurring from the Spotify ad-supported tier to the Spotify subscription tier, but instead should seek to assess the difference in the upselling capabilities of the Spotify ad-supported benchmark compared to statutory services. Dr. Peterson noted that Mr. Orszag did not attempt such an analysis, despite evidence that statutory services are funneling consumers into subscription offerings. Therefore, he suggested, the Judges should reject Mr. Orszag's incomplete attempt to support a [REDACTED] \times upward adjustment without comparing the upsell potential of Spotify against statutory services such as Google, Pandora, and iHeart. Peterson WDT ¶¶ 60-61.

Dr. Peterson further countered Mr. Orszag's suggested adjustment by offering that the premise for applying an upsell adjustment is unfounded. He argued that the evidence does not support the notion that [REDACTED] that accounts for the conversion of users to subscription tiers. Instead, he contended that the labels [REDACTED]. Google notes testimony from executives at Warner Music and UMG regarding both [REDACTED]. Dr. Peterson suggested that Mr. Orszag's analysis was erroneous because he arrived upon a ratio using headline per-play rates ([REDACTED]) to form a proposed adjustment to

²¹¹ Pandora and Sirius XM's expert witness Professor Shapiro also accepted a similar [REDACTED] upward adjustment. *See, e.g.*, 8/19/20 Tr. 2913, 2921, 2970 (Shapiro) ("I have calculated, for the same calculation he did ... that the proper adjustment would be a [REDACTED] adjustment factor.... [W]e did the same calculation and we both got to this same number.... And that ratio is also [REDACTED]. So we're doing the same thing.... I [had] said something like the [REDACTED], but Mr. Orszag corrected me and pointed out it should be [REDACTED].").

apply to Dr. Peterson's analysis, which is based on effective rates [REDACTED].

Peterson WDT ¶¶ 62-65.

Relatedly, in the hearing Dr. Peterson offered an alternative adjustment to account for funneling or conversion from ad-supported to paid subscription, whereby the starting point for his analysis (to which his proposed adjustments would be applied) would be the [REDACTED] for ad-supported customers who used the ad-supported service [REDACTED], as opposed to the payments due under the [REDACTED]. He reasoned this starting point may be appropriate if the Judges feel they need additional adjustment for funneling value, because any funneling value, [REDACTED], would have been exhausted or otherwise be *de minimis*. And, he offered, that was the amount [REDACTED] was willing to accept under the agreement. 8/26/20 Tr. 3955, 3960, 3961-63 (Peterson).

b. Dr. Peterson's Adjustments

Dr. Peterson and Google proposed four adjustments to the benchmark rates for ad-supported webcasters: (1) an interactivity adjustment, (2) a skips adjustment, (3) an effective competition adjustment, and (4) a marketing adjustment. Peterson WDT ¶¶ 15.²¹²

i. Dr. Peterson's Proposed Interactivity Adjustment

Dr. Peterson proposed a downward interactivity adjustment because the benchmark agreements he used are from an interactive market, whereas the target,

²¹² Dr. Peterson's testimony also suggested that the decrease in length of the average hit song indicates that per-play rates should decrease. Peterson WDT ¶¶ 78-79 (suggesting that a hit-driven station would have to play more songs per hour such that any decrease in the statutory rate is likely to be offset, at least partially, by an increase in the number of royalty-bearing plays). Google did not argue for such an adjustment but instead suggested the issue as a reason to view its rate proposal as a modest one. Google PFFCL ¶ 79.

statutory market is for non-interactive. 8/25/20 Tr. 3632, 3638 (Peterson). His testimony noted that interactive services receive a greater grant of rights (including the ability to let listeners hear on-demand whatever songs they want whenever they wish) and that licensors expect higher rates from interactive licenses than non-interactive licenses. Peterson WDT ¶ 52; 8/25/20 Tr. 3648 (Peterson).

Dr. Peterson proposed a downward interactivity adjustment of [REDACTED]%. 8/25/20 Tr. 3632 (Peterson); Peterson WDT ¶¶ 15(a), 55. His proposal came from his comparison of [REDACTED] [REDACTED] service to the statutory rate. 8/25/20 Tr. 3642 (Peterson); Peterson WDT ¶¶ 53-55. Peterson explained that [REDACTED] service, while meeting most of the statutory criteria, is not eligible for the statutory license because it [REDACTED], and that [REDACTED]. 8/25/20 Tr. 3641-43 (Peterson); Peterson WDT ¶¶ 53, 54. Dr. Peterson offered that the incremental amount [REDACTED] agreed to pay above the statutory rate is a useful measure of how a willing buyer and willing seller value the additional interactive functionality. Peterson WDT ¶ 54; *see also* 8/25/20 Tr. 3649, 3678-79 (Peterson). He set forth that the [REDACTED]% difference represents an incremental premium [REDACTED] paid for non-statutory functionality and that the difference is not meaningfully influenced by the statutory rate, but rather, that the comparison with the statutory rate allows for calculation of the delta between the respective rates. 8/25/20 Tr. 3632; 3646 (Peterson).

ii. Dr. Peterson's Proposed Skips Adjustment

Dr. Peterson also proposed to make a skips adjustment, which he asserts is required because the noninteractive licensees are required by statute to pay for plays under thirty seconds, but the benchmark interactive services do not pay for such brief plays. Peterson WDT ¶ 67. Dr. Peterson set out that the effective per-play rate he calculated (total royalties paid/reported streams) has a denominator (streams 30 seconds or longer) that excludes plays for which a statutory service would pay, thus leading to a

higher per-play rate for interactive services. Peterson WDT ¶ 67. Based on information from Spotify on the number of total plays and plays of less than 30 seconds on its ad-supported interactive service, Dr. Peterson calculated that a downward adjustment of [REDACTED]%, applied to Spotify's effective per-play rate results in what Spotify would have paid on a dollar-per-stream basis. *See* 8/25/20 Tr. 3680-81 (Peterson); Peterson WDT ¶¶ 15(c), 68. He proposed an alternative skips adjustment by calculating the adjustment to the statutory rate that would be required for statutory payments to remain unchanged if statutory services were to pay only on performances of 30 seconds or longer. He offered that relevant information provided from Pandora showed that on its ad-supported radio service [REDACTED]% of total performances are less than 30 seconds, thus leading him to arrive at an alternative [REDACTED]% reduction in the benchmark rate to account for skips. *Id.*

iii. Dr. Peterson's Proposed Effective Competition Adjustment

As with other participants and experts, Google and Dr. Peterson propose that a competition adjustment is necessary because labels have complementary oligopoly power in the benchmark market for licensing of music services, which means those rates do not reflect effective competition, but rather they result in royalty rates set at supracompetitive levels even higher than a single monopolist would charge. 8/25/20 Tr. 3652-53 (Peterson); *see also* Peterson WDT ¶¶ 19, 21-22, 34-35. Dr. Peterson offered that the consumer expectation that all interactive services will have the full catalog of each significant record label means that the labels' catalogs do not substitute for one another and are instead "must haves" for interactive services, which thus creates a licensing market where the major labels have complementary oligopoly power. 8/25/20 Tr. 3653 (Peterson); Peterson WDT ¶¶ 33, 57.

Dr. Peterson also set out that statutory streaming services have a greater ability to steer listeners' experience than interactive services, using techniques such as designing

playlists to meet listeners' tastes that omit recordings from certain labels or reducing the number of plays for a given label's recordings if the license rate is too high. Dr. Peterson opines that this ability to steer is a marker of effective competition. Peterson WDT ¶ 58-59. He sought to replicate such effective competition through his competition adjustment, which reflects a statutory licensee's ability to avoid high license rates by substituting or steering away from high royalties. Peterson WDT ¶¶ 65-66; *see also* 8/25/20 Tr. 3662 (Peterson). Dr. Peterson offered an analysis that chiefly used a Pandora-Merlin agreement that was in effect at the time of *Web IV*, which required Pandora to increase (*i.e.*, steer toward) Merlin spins by at least 12.5% and allowed Pandora to effectively engage in significant steering without negative reaction, to arrive at a proposed lower bound for his downward competition adjustment of 11.1% — $12.5/(100+12.5) = 11.1\%$. Peterson WDT ¶¶ 62, 65. Dr. Peterson also looked to an agreement between iHeart and Warner, in effect at the time of *Web IV*, with a different [REDACTED] structure which required iHeart to pay royalties to Warner [REDACTED] at the time the deal was struck, which Dr. Peterson found indicative of an intention to steer of more than 50%. Peterson WDT ¶ 63. In his analysis, he set out that evidence of the ability to steer ranges from [REDACTED]% in the case of the Pandora/Merlin agreement to more than 50% in the case of iHeart/Warner. Dr. Peterson also looked at Pandora's steering experiments, cited in the *Web IV* determination, finding some consumer resistance to steering at a rate of 30%, thus arriving at a proposed upper bound for the downward competition adjustment of [REDACTED]% [REDACTED]. Peterson WDT ¶¶ 62, 65.

Dr. Peterson asserted that his competition adjustment is conservative because it is calculated based only on a reasonable ability to steer, which does not fully address or compensate for complementary oligopoly power. 8/25/20 Tr. 3662-63, 3664-65 (Peterson). He added that other market data supports that even higher levels of steering

are possible in the target noninteractive market, again noting evidence that Pandora engaged in steering toward Merlin by [REDACTED]% (instead of [REDACTED]%), without negative feedback. Peterson WDT ¶ 62.

iv. Dr. Peterson's Proposed Marketing Adjustment

Dr. Peterson offered that a marketing adjustment to the Spotify benchmark licenses may not be appropriate. While he recognized that the agreements [REDACTED], he concluded that the value of [REDACTED] may be zero. The provisions, he indicated, [REDACTED]. Peterson WDT ¶ 69. Dr. Peterson offered that the marketing value stated in the Spotify benchmark licenses likely does not reflect [REDACTED]. Peterson WDT ¶¶ 69-70. Dr. Peterson calculated a potential valuation by allocating the total advertising value across active countries and dividing the value of advertising attributable to the United States by the number of performances. Dr. Peterson determined this additional unadjusted value at \$[REDACTED] per play. To address any uncertainty of the actual value of such negotiated advertising in the current record, Dr. Peterson calculated the adjusted Spotify benchmark range with and without the advertising adjustment. Peterson WDT ¶¶ 71, 75. Google argues that no advertising adjustment is justified, given the acknowledged uncertainties in assigning specific valuation and admitted inability to value such benefits on a dollar-for-dollar basis with the value stated in the agreements. Google PFFCL ¶¶ 66-69.

v. Dr. Peterson's Application of his proposed adjustments

The range of Dr. Peterson's proposed adjustments are reflected below, in Dr. Peterson's Figure 2. Peterson WDT ¶ 74.

The top section of each panel shows the unadjusted benchmark rates and the adjusted rates based on three adjustments (Interactivity, Competition and Skips adjustments). In order to determine the benchmark rate reflecting these adjustments the

unadjusted rate is multiplied by one minus the adjustment for each rate. Thus, the adjusted rates are equal to:

$$\text{Adjusted Rate} = (1 - \text{Interactivity Adj}) \times (1 - \text{Competition Adj}) \times (1 - \text{Skips Adj}) \times \text{Unadjusted Rate}.$$

Peterson WDT ¶ 74.

The top panel of Figure 2 uses the [REDACTED]% Skips adjustments and the bottom panel uses the [REDACTED]% skip rate. The adjustment range of [REDACTED]% to [REDACTED]% using the Pandora free tier skips data is arrived at by applying, to the Unadjusted Rate, Dr. Peterson's proposed interactivity adjustment of [REDACTED]%, Skips adjustment of [REDACTED]% (Pandora free tier), and competition adjustment of [REDACTED]%. The adjustment range of [REDACTED]% to [REDACTED]% using the Spotify free tier skips data is arrived at by applying Dr. Peterson's proposed interactivity adjustment of [REDACTED]%, skips adjustment of [REDACTED]% (Spotify free tier), and competition adjustment of [REDACTED]%. The range of adjusted rates before accounting for the potential value of marketing support is \$[REDACTED] to \$[REDACTED] per play. Dr. Peterson offered the midpoint of this range as being a reasonable estimate of a rate, when treating advertising allowances as having no value. That midpoint is equal to \$[REDACTED] per play. Peterson WDT ¶ 74; Figure 2.

Both the top and bottom panels of Figure 2 show the calculation of the adjusted value of advertising in the benchmark agreements. The top row of the middle section reflects the unadjusted value of advertising per play in the United States. The value is calculated by allocating the total advertising value across active countries and dividing the value of advertising attributable to the United States by the number of performances. The adjusted advertising ranges are calculated in the same way as the adjusted rates indicated above, where the adjusted rate = $(1 - \text{Interactivity Adj}) \times (1 - \text{Competition Adj})$

$\times (1 - \text{Skips Adj}) \times \text{Unadjusted Rate}$. The range of adjusted benchmark rates including the stated value of advertising allowances is \$[REDACTED] to \$[REDACTED] per play. Dr. Peterson offered the midpoint of this range as being a reasonable estimate of a rate, when advertising allowances are included. The midpoint is equal to \$[REDACTED] per play. Peterson WDT ¶¶ 75-76.

Figure 2

The Adjusted Benchmarks

[RESTRICTED]

[REDACTED]

c. SoundExchange's Criticisms of Dr. Peterson's Ad-Supported Benchmark Model

SoundExchange acknowledges that the Judges have found benchmark-based approaches useful in the past. However, SoundExchange disputes that the Judges have expressed a preference of benchmarking over other approaches, such as modeling. Instead, it offers that the Judges have assessed each type of analysis on the merits, as established by the record in each case. SoundExchange's Corrected Replies to Google's Amended Proposed Findings of Fact and Conclusions of Law ¶¶ 14-17 (SX RPFCL (to Google)).

SoundExchange also initially disputed that the benchmarks proposed by Google are appropriate. SoundExchange argues that Dr. Peterson improperly used Spotify's ad-supported rates as a benchmark, suggesting that subscription interactive services are a better starting point than ad-supported interactive services. SoundExchange also urged

that Spotify's ad-supported service should not be used as a benchmark without an upward adjustment to account for its [REDACTED] ability to promote sales of subscriptions. SX PPFCL (to Google) ¶¶ 22-26. However, in the hearing Mr. Orszag testified that he had become "comfortable" with applying Spotify's *ad-supported rate* as the benchmark in his own ratio equivalency model. He came to this conclusion after discerning that [REDACTED]." 8/25/20 Tr. 3809 (Orszag). When a [REDACTED] × adjustment was made to control for the separate value of funneling/conversion, Mr. Orszag became, if not a full-fledged convert, "more comfortable" with the "Spotify Free benchmark." 8/25/20 Tr. 3816 (Orszag).

i. SoundExchange's Criticisms of Dr. Peterson's Proposed

Interactivity Adjustment

SoundExchange faults Dr. Peterson's interactivity adjustment because, in its view, the adjustment is not based sufficiently on the incremental value placed on the interactive functionality by consumers in the downstream market. It notes that in past cases the Judges have accepted interactivity adjustments based on downstream market value, evidenced by consumers' willingness to pay for the functionality. It offers that there is little evidence from Google that consumers actually value the additional functionality that [REDACTED] obtained under its direct licenses and that, in fact, the additional functionality on [REDACTED]'s ad-supported service was minimal. SX PPFCL ¶ 228-231; *Web IV*, 81 FR at 26345, 26348; *see also Web II*, 72 FR at 24902 (accepting SoundExchange's interactivity adjustment, based on average consumer subscription price and the average per-subscriber royalty rate for on-demand services). SoundExchange adds that Dr. Peterson was unable to indicate whether increased functionality generated more revenue per play on the ad-supported tier. SX PPFCL ¶ 232; 8/11/20 Tr. 1401 (Orszag). It adds that, per [REDACTED] (Trial Ex. 5321), [REDACTED]. SX PPFCL ¶ 232. SoundExchange suggests that the true motivation for [REDACTED] to license the

increased functionality was to offer customers a sample of the full interactive function as a way to promote and upsell its subscription interactive service. SX PFFCL ¶¶ 235-236; 8/31/20 Tr. 4646 (Phillips).

SoundExchange asserts that Dr. Peterson's interactivity adjustment — being based on a comparison of [REDACTED]'s effective per-play rate for its ad-supported [REDACTED] service to the statutory rate — is based in part on the statutory rate, which violates requirements that benchmark rates be free from the influence of regulation. Sound Exchange raises further issues with regard to the relationship between the negotiated and statutory rates, with Mr. Orszag testifying that if the statutory rate that Dr. Peterson relied on in his adjustment is too low (as SoundExchange argues it is) then Dr. Peterson's interactivity adjustment will be too large. SX PFFCL ¶¶ 237-239; Orszag WRT ¶ 95.

ii. SoundExchange's Criticisms of Dr. Peterson's "Skips"

Adjustment

SoundExchange questions the probative value of the data upon which Dr. Peterson relies for his [REDACTED]% skips adjustment on the same basis as it challenges his application of this data to Professor Shapiro skips adjustment. SoundExchange notes that Dr. Peterson's data came from noninteractive plays available on all three tiers of Pandora's service, ad-supported, mid-tier, and fully interactive. 8/20/20 Tr. 3028-29 (Shapiro). As a consequence, Mr. Orszag asserts, the [REDACTED]% "skips" rate is likely overstated, because subscribers to Pandora's two interactive tiers have unlimited skips, making them more likely to skip when accessing noninteractive plays on those two tiers. Orszag WRT ¶ 120. SoundExchange notes that Professor Shapiro agrees with the concern in principle but testified that any such upward bias [REDACTED], so he did not measure the effect. 8/20/20 Tr. 3030-32 (Shapiro).

SoundExchange also takes issue with Dr. Peterson's alternative skips adjustment and its reliance on the Spotify ad-supported service's skip rate [REDACTED]%), alleging Dr. Peterson's analysis is faulty for only considering the benchmark market's skip rate and ignoring the target market's skip rate. It argues that Spotify pays for its ad-supported service on a percentage of revenue basis and, therefore, whether Spotify's skip rate is [REDACTED]% has no impact on what Spotify pays the record companies on the percentage of revenue basis. It notes Mr. Orszag's view that the benchmark market's skip rate may only be used if there is a basis to assume that the benchmark market and the target market have the same skip rate and that there is no evidentiary basis for such a conclusion. SX PFFCL ¶¶ 244-247.

iii. SoundExchange's Criticisms of Dr. Peterson's Effective Competition Adjustment

SoundExchange criticizes Dr. Peterson's analysis asserting that it relied on stale evidence, from the time of *Web IV*, namely a 2014 agreement between Merlin and Pandora, a 2013 agreement between iHeart and WMG, and a 2014 litigation experiment conducted by Pandora. SoundExchange argues that the market for subscription interactive services has changed since *Web IV*, and that the increased competition would require a downward shift of the competition adjustment used in *Web IV*. It adds that the application of the evidence from *Web IV* would need to account for the differing market evidence used in that proceeding, involving many services and not just the service with the [REDACTED]. SX PFFCL ¶¶ 490-493.

iv. SoundExchange's Reaction to Dr. Peterson's Proposed Marketing Adjustment

SoundExchange reiterates that value is derived by the record companies in the relevant agreements through provisions for the streaming services to provide marketing support in the form of uncompensated advertisements to the record labels. SX PFFCL ¶¶

490-493. It points out that Dr. Peterson calculated proposed adjustments based on advertising benefits and that Google should not be able to walk away from the adjustments. SX RPFCL (to Google) ¶ 69.

d. The Judges' Analysis and Findings Regarding Dr. Peterson's Ad-Supported Benchmark Model

As an initial matter, the Judges clarify that they do not strictly adhere to any preference toward any particular method of analysis, benchmark or otherwise, but instead assess all reasoned analyses on their merits and on the record of each case.

Taking into account the entirety of the record, the Judges determine that it is appropriate to utilize the proposed benchmarks from the interactive ad-supported market, provided that an appropriate conversion adjustment is applied.²¹³ The Judges apply the aforementioned [REDACTED] × adjustment to the rates for [REDACTED]). Where negotiated provisions place a value on funneling in the benchmark agreements, the Judges find an adjustment is appropriate. While Dr. Peterson started his analysis with the higher-end per-play rate under the [REDACTED] for customers who [REDACTED], the Judges note that this is not necessarily the [REDACTED]. The Judges find that Mr. Orszag's proposal is a superior mode to account for the value of funneling. However, as there is insufficient evidence and analysis of analogous funneling value in the [REDACTED], the Judges make no such adjustment to those benchmark rates.

Applying this [REDACTED] factor to Dr. Peterson's calculated per-play rates for [REDACTED], results in a final effective rate of \$[REDACTED] (*i.e.*, \$[REDACTED] x [REDACTED]) or \$[REDACTED] (rounded) [REDACTED]; and \$[REDACTED] (*i.e.*, \$[REDACTED] x [REDACTED]) or \$[REDACTED] (rounded) for [REDACTED].

²¹³ The Judges find insufficient basis to find that any shift in song length is not adequately accounted for in the benchmark markets.

The starting point benchmark per-play rates calculated by Dr. Peterson for [REDACTED] remain.

**i. The Judges' Analysis and Findings Regarding Dr. Peterson's
Proposed Adjustments**

**(A) The Judges' Analysis and Findings Regarding Dr. Peterson's
Proposed Interactivity Adjustments**

Based on the entirety of the record, the Judges decline to apply Dr. Peterson's—proposed interactivity adjustments. The Judges agree with SoundExchange that the record does not clearly demonstrate added economic value for interactivity as a suitable basis to adjust the proposed benchmark rates downward. Advertisers, not listeners, pay the royalties. And there is insufficient evidence to establish that advertisers make payments to noninteractive ad-supported services based upon the level of interactivity of that service.

While we do not foreclose the possibility of a record that may allow measuring interactivity value by looking toward how the service and the labels (as opposed to downstream users) value that interactivity in an ad-supported context, on this record the Judges will not apply an interactivity analysis which fails to appropriately consider oligopoly power in a direct deal such as the proposed [REDACTED] benchmark. The Judges' decline to apply the proposed interactivity adjustment in part because the record, [REDACTED], indicates that major labels exert oligopoly power in similar direct deals. When Judge Strickler asked Dr. Peterson whether any of the proposed [REDACTED]% adjustment for interactivity constitutes a complementary oligopoly premium, he conceded that he could not preclude that oligopoly power could be a cause of the higher rate. 8/25/20 Tr. 3645 (Peterson). Absent accurate consideration of oligopoly power, which is persuasively established elsewhere, we find it inappropriate to apply the proposed interactivity adjustment.

(B) The Judges' Analysis and Findings regarding Dr. Peterson's

Proposed Skips Adjustment

As indicated previously, the Judges are in agreement with SoundExchange's criticisms of both Professor Shapiro's and Dr. Peterson's skips adjustment for ad-supported services. Additionally the Judges agree that the reliance on the Spotify ad-supported service's skip rate ([REDACTED]%) as a basis for adjustment is in error. The Judges agree that there is insufficient basis to conclude that the benchmark market and the target market have the same skip rate, and that absent reliable evidence to that effect a direct adjustment as proposed would be incorrect. Accordingly, and based on the entire record, the Judges adopt (and incorporate by reference here) the same analysis and the same finding of a [REDACTED]% skips adjustment as they found for the subscription market.

(C) The Judges' Analysis and Findings regarding Dr. Peterson's

Proposed Competition adjustment

Taking into account the entirety of the record, the Judges are persuaded of the necessity to apply an effective competition adjustment. For the reasons discussed with regard to the effective competition adjustment to Professor Shapiro's ad-supported benchmark, the Judges apply a 12% effective competition adjustment to Dr. Peterson's ad-supported rate. The Judges' Analysis and Findings regarding Dr. Peterson's Proposed Marketing Adjustment

Based on the entirety of the record, the Judges find that it is appropriate to apply the marketing adjustment, as offered by Dr. Peterson. While we note that Google and Dr. Peterson offer rationales that an adjustment may not be appropriate, Dr. Peterson also found a basis to place a value on this factor. Additionally, while Dr. Peterson offers calculations performed with and without the marketing adjustment, his ultimate analytical step, finding a midpoint within the range of rates he calculated, was done based on

calculations that included the marketing adjustment. Finally, we are in agreement with SoundExchange that Google has not offered a sufficient basis to distance itself or the Judges from applying a factor offered by Google's own expert analysis.

ii. Dr. Peterson's Benchmark Rate as Adjusted by the Judges

In sum, the Judges find as follows with regard to Dr. Peterson's proposed ad-supported benchmark rate:

1. The effective ad-supported benchmark per-play rates of \$[REDACTED] for [REDACTED], \$[REDACTED] for [REDACTED], \$[REDACTED] for [REDACTED], \$[REDACTED] for [REDACTED], and \$[REDACTED] for [REDACTED] are in the range of a reasonable starting point.
2. Applying the [REDACTED] \times factor to account for funneling/conversion to Dr. Peterson's calculated per-play rates for [REDACTED], results in a final effective rate of \$[REDACTED] (*i.e.*, \$[REDACTED] \times [REDACTED]) or \$[REDACTED] (rounded) for [REDACTED]; and \$[REDACTED] (*i.e.*, \$[REDACTED] \times [REDACTED]) or \$[REDACTED] (rounded) for [REDACTED]. The starting point benchmark per-play rates calculated by Dr. Peterson's for [REDACTED] remain respectively as \$[REDACTED], \$[REDACTED], and \$[REDACTED].
3. The interactivity adjustment is rejected.
4. The skips adjustment is reduced to [REDACTED]%, properly reducing the interim calculation to \$[REDACTED] (rounded) for [REDACTED], \$[REDACTED] (rounded) for [REDACTED], \$[REDACTED] (rounded) for [REDACTED], \$[REDACTED] (rounded) for [REDACTED], and \$[REDACTED] (rounded) for [REDACTED].
5. The 24% effective competition adjustment proposed by Dr. Peterson is rejected.

6. The Judges apply the 12% effective competition adjustment. This effective competition adjustment properly reduces the interim calculation to
 $\$[\text{REDACTED}]$ (rounded) for $[\text{REDACTED}]$, $\$[\text{REDACTED}]$ (rounded) for $[\text{REDACTED}]$, $\$[\text{REDACTED}]$ (rounded) for $[\text{REDACTED}]$, and $\$[\text{REDACTED}]$ (rounded) for $[\text{REDACTED}]$.
7. Applying the Marketing adjustments set forth by Dr. Peterson, increasing the per-play rates as follows of $\$[\text{REDACTED}]$ $[\$[\text{REDACTED}] + \$[\text{REDACTED}]]$ for $[\text{REDACTED}]$, $\$[\text{REDACTED}]$ $[\$[\text{REDACTED}] + \$[\text{REDACTED}]]$ for $[\text{REDACTED}]$, $\$[\text{REDACTED}]$ $[\$[\text{REDACTED}] + \$[\text{REDACTED}]]$ for $[\text{REDACTED}]$, $\$[\text{REDACTED}]$ $[\$[\text{REDACTED}] + \$[\text{REDACTED}]]$ for $[\text{REDACTED}]$, and $\$[\text{REDACTED}]$ $[\$[\text{REDACTED}] + \$[\text{REDACTED}]]$ for $[\text{REDACTED}]$.
8. The range of adjusted rates is **\$0.00197** and **\$0.00228** per play, and the midpoint of **\$0.002125**, when rounded (or, more precisely, rounded further) is **\$0.0021**, which is a reasonable estimate of the rate applying the Judges' modifications to Dr. Peterson's model.

5. **Separate Rate for Nonportable Services**

a. **Google's Proposal**

Google seeks a separate rate for certain nonportable uses, citing the statutory directive that the Judges "shall distinguish among the different types of services then in operation." 17 U.S.C. 114(f)(1)(B). Google argues that the rise of nonportable smart speaker devices, and streaming services tailored to those devices, has created such a different type of service. Google PFFCL ¶¶ 91-92. It offers that separate rates for nonportable uses have been adopted by the Board in other regulations and that the Judges should set a separate rate for nonportable, nonsubscription services that is 50% of

whatever headline rate the Judges set for portable nonsubscription services. Google PFFCL ¶¶ 93-94. Specifically, Google seeks a per-performance rate for the new type of service that it refers to as “Nonsubscription Nonportable Webcasting Services” which Google proposes to define as “a service offered by a Licensee that makes an Eligible Transmission available solely over a nonportable device, such as a smart speaker, a smart home appliance, or a personal computer.” Google Proposed Rates and Terms at 3.

Google offers proposed benchmark licenses between major labels ([REDACTED]) with Google as evidence in support of its proposal, which include [REDACTED]. Google PFFCL ¶ 102. It [REDACTED]. Google PFFCL ¶ 103. Google asserts that the [REDACTED] reflect an understanding that consumers are willing to pay an incremental amount for the ability to take music with them on phones and portable devices. Google PFFCL ¶ 104. Google also points toward lower rate structures for certain nonportable services in the context of the mechanical compulsory license under 17 U.S.C. 115. Google PFFCL ¶ 105.

b. SoundExchange’s Criticism of Google’s Proposal for a Separate Rate for Nonportable Services

SoundExchange asserts that Google has not established that streaming services that are available only on nonportable devices are a different type of service warranting a different rate, and that there is no evidence that a willing buyer and willing seller would agree to lower rates for such a service. SX RPFFCL (to Google) ¶ 94. It contends that Google confuses nonportable devices with nonportable services in its attempts to highlight “Nonsubscription Nonportable Webcasting Services” as an allegedly different type of service. SoundExchange argues that the dichotomy that Google proposes is undermined by the fact that portable services can also be consumed on nonportable devices. SX RPFFCL (to Google) ¶ 96. SoundExchange challenges the notion that any growing popularity of smart speakers supports the notion that streaming services that can

only be operated on a smart speaker are growing in popularity or exist as a different type of service. SX RPPFCL (to Google) ¶ 97. It argues that Google “bears the burden of demonstrating not only that” nonportable services “differ[] from other forms of commercial webcasting, but also that [they differ] in ways that would cause willing buyers and willing sellers to agree to a lower royalty rate in the hypothetical market.” SX RPPFCL (to Google) ¶ 100 (citing *Web IV*, 81 FR at 26320 (applying that principle to simulcasters)).

SoundExchange contends that the proposed benchmark agreements do not match up with Google’s rate proposal. It notes that the [REDACTED]. Through Mr. Orszag, SoundExchange posits that [REDACTED] and does not support the notion that the rate should be half of the per-performance rate for a service available on a broader range of devices. SX RPPFCL (to Google) ¶ 94; Orszag WRT ¶¶ 139-140.

SoundExchange further addresses concerns that the proposed benchmarks do not provide useful information about the *per-performance* rate for a service tier accessible on *multiple* nonportable devices to which a willing buyer and a willing seller would agree. SX RPPFCL (to Google) ¶ 101. It notes that even if the offered [REDACTED] were relevant, it would be inappropriate to attribute all of the difference in [REDACTED] to nonportability because the rates are also driven by the fact that they are for single-device services, which excluded classes of devices that would be eligible under Google’s proposed rates and terms, *e.g.*, a personal computer. SoundExchange suggests these distinctions discount the notion that [REDACTED]. SX RPPFCL (to Google) ¶¶ 102-104, 110. SoundExchange also challenges the notion that the cited rates for certain nonportable mechanical licensing royalties are not appropriate support for Google’s proposal because they address different rights to different works with different sellers. SX RPPFCL (to Google) ¶¶ 104-106.

**c. The Judges' Analysis and Findings regarding Google's Proposal for a
Separate Rate for Nonportable Services**

Based on the entirety of the record the Judges are not persuaded that Google has established the basis for a separate rate for Nonsubscription Nonportable Webcasting Services. While the Judges have concerns about the extent to which the [REDACTED] and the appropriate use of mechanical rates within the context of the section 115 compulsory regime as persuasive evidence for the purpose of sustaining a separate rate, those are relatively minor concerns. The Judges find the case for a separate rate is most profoundly undermined because the requested rates would extend far beyond the bounds of the proposed benchmark agreements.

The benchmark agreements are tied to [REDACTED] and to very specific device characteristics,²¹⁴ whereas the requested rate (and defined bounds) are not tied or specifically limited to the same specific types of devices, nor are they limited to [REDACTED]. This makes them poor benchmarks and makes for a poor case for the existence of the requested distinct different type of service. Furthermore, Google did not adequately acknowledge or offer appropriate adjustments to account for the fairly profound distinctions between its request and the limitations represented in its proposed benchmarks. While the Judges may amend a request to comport with the offered evidence, on this record we find an inadequate basis to do so. Additionally, in a case such as this where the request diverts so profoundly from the offered benchmark evidence, prudence compels the Judges not to engage in such refining of the requested rates or terms.

²¹⁴ [REDACTED], Trial Ex. 5090 at 37 ([REDACTED] [REDACTED]); [REDACTED], Trial Ex. 1006 at 50 [REDACTED]; [REDACTED], Trial Ex. 1010 at 65-66 ([REDACTED]).

C. Evaluation of Game Theoretic Modelling Evidence

1. Professor Willig's Shapley Value Model

Professor Willig describes his Shapley Value Model as a “multi-party bargaining approach.” Willig WDT ¶ 9. He explains that his Shapley Value Model is a form of economic game theory that assumes a “cooperative” relationship among the bargaining parties, *id.* ¶ 12, providing a “generalized solution to the problem of how to apportion among the members of a multi-party bargaining group the surplus created by their productive cooperation with each other.” *Id.* ¶ 14.²¹⁵

Professor Willig's Shapley Value Model indicates a royalty rate for *ad-supported* noninteractive services of \$0.0028 per play in 2021, and, for *subscription* noninteractive services, a per-play royalty rate of \$0.0030 in 2021. Willig WDT ¶ 55. He derives these 2021 royalty rates from the average royalty rates over the entire five-year (2021-2025) rate period generated by his Shapley modeling, which are \$0.0030 and \$0.0031 for the ad-supported and subscription services, respectively.²¹⁶

According to Professor Willig, the Shapley Value Model has properties that make it well suited for establishing royalties in this proceeding. He explains that this modeling, when combined with relevant data, identifies the following values and properties:

²¹⁵ A “cooperative” game assumes that the participants’ “joint action agreements are enforceable,” and are distinguished from “non-cooperative games,” “in which such enforcement is not possible, and individual participants must be allowed to act in their own interests.” AVINASH DIXIT ET AL., GAMES OF STRATEGY 26 (3d ed. 2009).

²¹⁶ More particularly, Professor Willig derives his proposed 2021 rates from his five-year average by discounting back from the mid-point of the rate period to the start of the period, using the Federal Reserve Open Market Committee's inflation forecast. *Id.*

1. The “fallback value” which any party (record company or streaming service in the present case) could create on its own without an agreement among one or more of the other parties. Willig WDT ¶ 13.
2. The extra value – the Shapley “surplus” – that the parties collectively could generate in “notional”²¹⁷ agreements with the other parties, above their fallback values. *Id.*
3. The ordering of “every possible combination of unilateral, bilateral and multilateral deals that may be struck by the different parties.” *Id.* ¶ 14.²¹⁸
4. The portions of the surplus – the “incremental contribution” – that each party adds to the total amount of value created, is “assessed as increments to every possible combination of unilateral, bilateral, and multilateral deals that may be struck by the different parties” *Id.*
5. Each party’s “incremental contribution” is then averaged across all such combinations.” *Id.*

Each party’s average incremental contribution is its Shapley Value. *Id.* ¶ 16 (“The Shapley Value accorded to a party rests on the value that it brings to the group’s cooperation, taking into account all the subsets of the group to which it can join.”).

²¹⁷ The Judges use “notional” to identify the negotiations assumed in Shapley Value modeling, and to distinguish those ersatz negotiations from the “hypothetical” negotiations the Judges must construct to establish the statutory royalty rates. More precisely, the “notional” Shapley Value negotiations generate “notional” royalty rates that may: (1) constitute a “hypothetical” rate that would constitute an effectively competitive rate; (2) fail to reflect a “hypothetical” effectively competitive rate; or (3) serve as a building block that, with adjustments or offsets, is an input into a “hypothetical” effectively competitive rate.

²¹⁸ As Professor Willig explains: “In Shapley Value analysis there are always $N!$ (*i.e.*, N factorial) different arrival orderings, where N is the number of negotiating parties. For example, with three negotiating parties, there are $3!$ (*i.e.*, $3 \times 2 \times 1$) = 6 different arrival orderings. *Id.* ¶ 20 n.13.

To further explain the Shapley Value concept, Professor Willig provides the following example:²¹⁹

The concept of a Shapley Value is best understood by reference to a simple analogy. Imagine that parties A, B, and C are negotiating a deal in person. Party C can be the first, the second, or the third to arrive in the room. The value it brings to the bargaining table may be contingent on the order in which it arrives. For example, if Party C is last to the negotiation it may have more bargaining power as a result of its ability to hold up or frustrate consummation of a deal to which Parties A and B are otherwise amenable. When C is first to the negotiation, it has no bargaining power over the others. Shapley analysis takes into account all such possible differences in Party C's bargaining power that are contingent on its order of arrival to the negotiation. It does so by taking the average of each "incremental value" created by Party C in each possible sequence of arrivals. As such, Party C's Shapley Value will only be high relative to the other parties' Shapley Values if, on average, it brings a relatively high incremental value to all possible orderings and sub-orderings of Parties A, B, and C.

Id. ¶ 15.

The value of a sub-set – *i.e.*, a Shapley coalition – prior to joinder by other parties to the notional negotiation, is denominated as its "Characteristic Function." The calculation of its Characteristic Function is "necessary to assess and delineate the value that can result from the cooperation of any subset of the overall cooperating group." *Id.* ¶ 17. The value of each coalition's Characteristic Function is based on the fundamental economic principle that a coalition of willing sellers (like any individual seller) "is assumed to act in the manner that maximizes the collective surplus of the coalition." Willig WDT app. C at C-4 (¶ 6 therein); *see also id.* app. F at F-4 (¶ 7 therein) (same). After specifying these coalitions and calculating the maximum values of their characteristic functions, the modeler can derive Shapley Values for each party to the notional Shapley "negotiation." *Id.* ¶ 33.

²¹⁹ In this proceeding, the economic experts appropriately proffer potentially illuminating examples (as in the accompanying text) in an attempt to state clearly the principles and methods underlying their work. The Judges find their use of such examples to be consistent with the evidentiary principles set forth in 37 CFR 351.10(e).

Professor Willig contends that Shapley Value modeling is related to the royalties that are to be determined in the present proceeding, with the record companies and the noninteractive streaming services constituting the “arriving” participants. The record companies must: (1) recover their opportunity costs,²²⁰ identified as their fallback values in Professor Willig’s model; and (2) receive their Shapley Values, *i.e.*, their average share of the surplus they contribute across all arrivals. Thus, unless royalty payouts are *high* enough to at least allow the record companies to receive their fallback values (*i.e.*, their opportunity costs) plus their Shapley Values, they would not license their repertoires to the noninteractive services. In similar fashion, the noninteractive services will receive their average share across all arrival orderings, corresponding to their Shapley Values (also calculated across all arrivals, of Shapley-derived Surplus). *See* Willig WDT ¶ 24 (describing this application of Shapley Value modeling).

According to Professor Willig, in this proceeding, a record company’s “opportunity costs” include any marginally higher royalties it might have earned by licensing to other distribution methods (such as, *e.g.*, interactive services), rather than licensing its sound recordings to noninteractive services.²²¹ Thus, he claims that Shapley

²²⁰ “The opportunity cost” of anything of value is what you must give up to get it,” and thus “is inseparably bound up with choice.” JOHN QUIGGIN, *ECONOMICS IN TWO LESSONS: WHY MARKETS WORK SO WELL, AND WHY THEY CAN FAIL SO BADLY* 15 (2019).

²²¹ Note that his application of the opportunity cost concept does not include the value of additional royalties that a record company would have earned *by licensing* its sound recordings to noninteractive services – such as royalties earned because some listeners to terrestrial radio, (which does not pay sound recording royalties) might have converted to noninteractive listening (as indicated by the surveys presented in this case, discussed *infra*, section IV.A). These negative opportunity costs (opportunity benefits) would need to be offset against the opportunity costs described by Professor Willig in the accompanying text, to determine *the net value of all opportunities foregone*. *See* Paul J. Ferraro and Laura O. Taylor, *Do*

Value modeling is “an appropriate approach for assessing rates that would be negotiated in the hypothetical marketplace for noninteractive webcasting [because it] fit[s] within the requirements of the relevant legal statute.” *Id.*

a. The Specifications in Professor Willig’s Shapley Value Model

A necessary initial step for an economist constructing a Shapley Value model is the delineation and enumeration of the parties to the notional negotiations, *i.e.*, the types and the number of sellers and buyers (licensors and licensees in this proceeding). *Id.* ¶ 25. According to Professor Willig, this process should “strike[] a balance between offering a granular and realistic description of the hypothetical market [while] maintaining enough simplicity around the number of entities being modeled such that the model can be readily solved and necessary data inputs can be estimated.” *Id.* ¶ 26.

In the notional negotiations of his Shapley modeling, Professor Willig assumes a market with four upstream record companies and two downstream noninteractive webcasting distributors. Willig WDT ¶ 25. Three of these four record companies represent each of the major record companies (Sony, Warner and Universal) (collectively the Majors), and the fourth represents a “combination” of all independent record companies (Indies). *Id.* Thus, these four entities comprise the entirety of the record company licensors in his market model. The two noninteractive services represent, respectively, a combination of all ad-supported noninteractive distributors, and a combination of all subscription noninteractive distributors, thus comprising the entirety of the noninteractive licensees. *Id.* According to Professor Willig, these assumptions strike the required balance between granular realism and model tractability. *Id.*

Economists Recognize an Opportunity Cost When They See One? A Dismal Performance from the Dismal Science, 4 J. ECON. ANALYSIS & POL’Y 1, 7 (2005) (“An avoided benefit is a cost, and an avoided cost is a benefit. Thus, the opportunity cost ... is ... the *net benefit forgone*.”) (emphasis added).

Professor Willig claims that the assumptions he makes regarding these specifications are necessary and prudent because they allow the model to generate the following economic information:

1. The effects of the “potentially different negotiating positions” of the Majors vis-à-vis the Indies.
2. The difference, if any, in royalty rates, between ad-supported noninteractive services, on the one hand, and subscription noninteractive services, on the other.
3. The effects of “competition between the collective ad-supported noninteractive distributor and the collective subscription noninteractive distributor.”

Willig WDT ¶ 26. Professor Willig adds that his model will generate royalty rates that are *lower* than would exist in the actual market because the model’s “grouping” of services “simplifies away rivalry among the various extant ad-supported noninteractive distributors and among the various extant subscription noninteractive distributors, [which] eliminate[es] consideration of competition within these groups of distributors,” artificially *elevating* “their respective market power. *Id.*”²²²

Next, Professor Willig calculates the value of the “characteristic functions” created by each possible cooperative grouping (“coalition”) of these six parties to the notional negotiation (*i.e.*, the four record companies and two noninteractive distributors). To make these “characteristic function” calculations, he first determines the value that each party or set of parties contributes upon arriving to the coalition. *Id.* ¶ 27.

²²² This specification may not be a simplification so much as an approximation of reality. As noted *infra*, Professor Willig finds that in the noninteractive market Pandora has a market share of more than [REDACTED]% in the ad supported and subscription sectors, respectively, making the “one noninteractive service” specification fairly realistic.

Starting with the record companies, Professor Willig defines the value each brings to these coalitions as “a function of both the costs it incurs and the revenue it could generate by licensing its sound recordings to distributors other than interactive services.” *Id.* ¶ 28. Professor Willig characterizes this value as a record company’s “fallback value” – *i.e.*, a value it would retain in the absence of agreements with the noninteractive distributors. *Id.*²²³

According to Professor Willig, –in order to determine this fallback value the model must “evaluat[e] what would happen if each noninteractive [service] did not have access to that record company’s music.” *Id.* ¶ 29. In that regard, he testifies that the model must explain – assuming the absence of noninteractive services from the market – “how much of each noninteractive [service’s] audience would divert to other music listening options (including to the other noninteractive distributor).” *Id.*²²⁴

Because of the importance to his Shapley Value Model of the value of this diversion, Professor Willig begins the model-building aspect of his testimony by describing the type of data necessary to calculate the diversionary impact of noninteractive services. Specifically, he explains that his model requires the following inputs:

1. The size of the audience of each noninteractive distributor;

²²³ Professor Willig acknowledged that the “fallback value” in his model doesn’t specify whether that fallback value is generated from markets that are perfectly competitive, monopolistically competitive, oligopolistic or monopolistic. 8/5/20 Tr. 378-79 (Willig).

²²⁴ As noted *supra*, his model does not net out the positive royalties record companies would earn by listeners who would listen to a noninteractive service rather than to terrestrial radio (or, any other non-royalty bearing substitute, such as listening to existing music sources or listening to less music, for that matter).

2. The diversion parameters that represent the proportion of these audiences that would divert to each alternative mode of distribution; and
3. The respective share of noninteractive plays for each record company specified in the model.

Id.

Professor Willig explains that the value the noninteractive services bring to the notional Shapley negotiation is based on the profits they can generate, *i.e.*, from the revenues they receive from subscribers and advertisers, less “various costs” – including the copyright royalties noninteractive services pay to music publishers for musical works.

Id. ¶ 30. These costs of course do not include the sound recording royalties, as these are the “unknowns” for which the Shapley Value model is intended to solve. *See id.* ¶ 30.

Professor Willig’s Shapley Value Model treats licenses from all three Majors as essential to the viability of a noninteractive service, in each Shapley subset of negotiating parties. As Professor Willig notes, incorporating this “must have” input into the Shapley Value model means that “without access to the sound recordings of all three of the major record companies, a noninteractive distributor does not operate and contributes zero profits to the rest of the subset of the bargaining parties.” Willig WDT ¶ 31.²²⁵

To support his treatment of each Major as a “Must Have,” Professor Willig relies on an abundance of record facts and prior statements by the Judges, as enumerated below.

²²⁵ By contrast, Professor Willig’s model does not assume that the repertoires of the specified aggregate of Indies are “must have” inputs for a noninteractive service. Rather, his model assumes that a noninteractive service without access to all of the Indies’ sound recordings would not suffer a complete loss of profits attributable to the Indies, but would instead would see a decline in profits commensurate with listeners’ preferences for content carried by [I]ndies.” *Id.*

First, Professor Willig notes that, in *Web IV*, the Judges stated that “[t]here appears to be a consensus that *the repertoire of each of the three Majors is a ‘must have’ in order for a noninteractive service to be viable.*” *Web IV*, 81 FR at 26373 (emphasis added). This statement by the Judges was supported by testimony in *Web IV*. In that proceeding, Professor Michael Katz, the NAB’s economic expert witness, and Professor Shapiro, testifying for Pandora, both declined to conclude that the Majors were not “Must Haves” for noninteractive services. *Web IV*, 81 FR at 26364. Additionally, in *Web IV* the Judges found that the “Must Have” status of noninteractive services was demonstrated by Pandora’s own data showing the high percentage of total plays on Pandora that were comprised of the most popular songs (hits), *i.e.*, from the top 5%, 10%, and 20% of “weekly spins,” a percentage greater than the total percent of overall plays of Majors’ recordings on Pandora. As the Judges stated, “[t]hese ‘top spin’ figures are indicative of the ‘must have’ aspect of the Majors’ repertoire,” and explain “why steering away from [the Majors’] repertoires cannot be pursued beyond a certain level, and why [Professor] Shapiro candidly declined to reject the idea that the Majors’ repertoires were ‘must haves’ even though noninteractive services could steer away from them to an extent.” *Id.* at 26373 n.155.

In this proceeding, SoundExchange notes that an even earlier proceeding took note of the importance to a noninteractive service of accessing all the “hits.” SX PFFCL ¶ 595 (citing *SDARS II*, 78 FR at 23064 (quoting a Sirius XM witness who testified that “Sirius XM is very hits driven, and they want to have the most successful service they can, so they’re going to use what’s popular.”)). Further, SoundExchange identifies the body of evidence in the present record that belies a view that a noninteractive streaming service could simply eliminate a Major’s entire repertoire:

Numerous documents produced by Pandora explain that [REDACTED]. Tr. Ex. 5153 at 35-56; *see* 8/5/20 Tr. 467:17-468:5 (Willig); 8/10/20 Tr. 960:3-961:1 (Willig); *see, e.g.*, Ex. 5156 at 17 [REDACTED] Ex. 5157 at 22

[REDACTED]); Ex. 5154 at 18 ([REDACTED]); Ex. 5155 at 31 ([REDACTED]); Ex. 5158 at 13 [REDACTED]).

SX PFFCL ¶ 596.²²⁶

The only new evidence that the Services proffer that would potentially support their claim that noninteractive services can move beyond steering and forego the entire repertoire of a Major are the results from Pandora's Label Suppression Experiments. However, as explained in the Judges' consideration of Professor Shapiro's game theoretic modeling they find that evidence to be deficient and accord it no weight.

For the foregoing reasons, the Judges find Professor Willig's decision to treat each of the three Majors as a "Must Have" to be reasonable and proper.

Having specified the "characteristic functions" in his model, Professor Willig derives the algebraic expression of the Shapley Values for each party in the negotiation styled by the Shapley Value methodology. *Id.* ¶ 33 & app. C. Applying the "characteristic function" concepts he delineated earlier, Professor Willig notes that his algebraic analysis identifies "[t]he difference between the characteristic function for a subset of the parties *without* the [noninteractive service] and the characteristic function for that subset *with* the [noninteractive service] added" *Id.* at 33. Applying this mathematical difference, Professor Willig states that his model allows for the implementation of the applicable "Shapley Value algorithm." *Id.* app. C at C-5 (¶ 9 therein). This algorithm allows Professor Willig to evaluate "every possible arrival ordering" and determine the negotiating parties' "incremental value." *Id.*

He then utilizes his model to determine the "incremental value" contributed by each "arriving" negotiating party identified in his model, relative to the value created by

²²⁶ SoundExchange also relies on evidence regarding the "Must Have" status of the Majors' individual repertoires to *interactive* services. The Judges do not find that evidence germane to the question of whether the Majors are "Must Haves" for *noninteractive* services.

the parties that preceded the “arriving” party. Professor Willig then averages the sum of these incremental contributions for each negotiating party across all 720 arrival orderings.²²⁷ *Id.* Each party’s average incremental contribution constitutes its individual Shapley Value.

Professor Willig next explains how his model makes the link between Shapley Values and the royalties to be paid to the record companies:

[O]nce Shapley Values are derived, the corresponding royalties from the two noninteractive distributors to the record companies can be computed. These are the payments that result in each party’s bottom line equaling its Shapley Value.

For each [noninteractive service], the total royalty payments it makes to the record companies must equal the difference between its profits from its market operations and its Shapley Value.

For each record company, the total royalty payments it receives must equal the difference between its Shapley Value and the total compensation it receives from its other sources of distribution, less its costs of operation.

Id. ¶ 34; *see also id.* app. C, p. C-6 (¶ 10 therein).

b. The Empirical Inputs in Professor Willig’s Shapley Value Model

Having specified his Shapley Value Model, Professor Willig then identifies the following necessary categories of data inputs:

1. royalty rates that record companies earn from other forms of music distribution;
2. noninteractive distributors’ audience sizes;
3. diversion ratios reflecting the amount of a noninteractive distributor’s audience that would switch to other forms of music distribution and generate royalties if that noninteractive distributor were unavailable;
4. record company play shares; and
5. noninteractive distributors’ fixed costs and marginal profit rates.

Willig WDT ¶ 35. He then explains how he selected the data for each of these five input categories, as described below.

²²⁷ Given the presence of six “players” in his model, there are 6! (*i.e.*, 720) arrival orderings.

i. Royalties from Other Forms of Distribution

Professor Willig uses “currently observable” sound recording rates as proxies for the sound recording royalty rates that will prevail during the rate period, 2021-2025. *Id.* ¶ 36. The *first* alternative category of distribution he considers is comprised of *subscription* on-demand streaming music and video services. Professor Willig obtains the royalty payment data detail for eight such services²²⁸ from the royalty statements of the three Majors and Merlin Network (Merlin), a digital rights agency for independent record labels. *Id.* ¶ 37.²²⁹ This royalty data reflected payment over the 12-month period ending March 2019, the most recent four-quarter period for which data was available to Professor Willig. *Id.* The average monthly royalties paid by these eight services, weighted by each service’s subscriber count, was approximately \$[REDACTED] per subscriber. *See id.* app. D at ex. D.1.

The *second* alternative rate/service category Professor Willig considers is comprised of *ad-supported* on-demand streaming music and video services. He obtained the royalty payment data detail for three such services – Spotify, YouTube (free version) and Vevo. *Id.* ¶ 38. The royalty data was produced by the same four entities that provided the royalty data for subscription on-demand services, and covered the same four-quarter time period. The average amount of royalties these three services paid over this period, weighted by each service’s total plays, was approximately \$[REDACTED] per play. *See id.* app. D at ex. D.2.

The *third* alternative rate/service category Professor Willig considers is Sirius XM *satellite radio transmission*. He obtained data on effective royalty rates, over the same

²²⁸ The eight services are: [REDACTED]. Willig WDT app. D, ex. D.1.

²²⁹ Merlin is a non-profit association for independent labels with more than 800 members representing tens of thousands of labels from 63 countries, including the United States. Orszag WDT ¶ 25.

12-month period identified above, from: (i) Statements of Account provided by Sirius XM to SoundExchange showing the dollar value of royalties paid for satellite radio performances; and (ii) Sirius XM's SEC Forms 10-K and 10-Q filings setting forth its subscriber counts. *Id.* ¶ 39 & n.21 (and exhibits referenced therein). Professor Willig uses these data to compute average monthly subscriber counts, and then divides that count into average monthly royalties. *Id.* This division results in Sirius XM monthly royalties per subscriber of \$[REDACTED].²³⁰

The *fourth* alternative royalty-bearing category Professor Willig considers is generated not by royalty payments from intermediaries, but rather by consumer payments to *purchase* digital downloads and physical music (*i.e.*, CDs and vinyl records). *Id.* ¶ 40. He relies on 2018 wholesale and retail sales data from the Recording Industry Association of America (RIAA) and from a 2018 Annual Music Study by an industry research firm, MusicWatch, prepared for the RIAA. These data provide information on the average dollar amount spent by purchasers of sound recordings in these formats. *Id.* Professor Willig also relies on additional 2018 RIAA data on the percent of the retail prices of digital downloads, CDs and vinyl records, respectively, that is paid as royalties on sales in these three categories. *Id.* ¶ 40 app. D at ex. D.3. He then multiplies each

²³⁰ Professor Willig asserts that the royalty rates he calculated for Sirius XM are “artificially” low, because they do not account for: (i) royalties paid through licenses directly negotiated between Sirius XM and certain record companies; or (ii) royalties that – only since the October 2018 enactment of the *Music Modernization Act* – SiriusXM must pay for its performance of sound recordings fixed prior to February 15, 1972. *See id.* n.22 (and accompanying text). However, because Professor Willig does not provide a basis for the Judges to make an actual or estimated adjustment based on this assertion, the Judges make no such adjustment.

retail revenue amount by the applicable royalty percentage, to generate the following calculation of “average monthly royalties per purchaser”:

\$[REDACTED] for digital download purchasers

\$[REDACTED] for CD purchasers

\$[REDACTED] for vinyl record purchasers

Professor Willig then calculates an average royalty per purchaser of \$[REDACTED], weighted by retail revenue percentages across these three sales formats. *Id.* app. D at ex. D.3.

The *fifth* (and final) alternative category of distribution Professor Willig considers is comprised of *AM/FM broadcasts* (to be clear, these are broadcasts via terrestrial radio rather than “simulcasts” over the internet) and a miscellaneous category for all other forms of music. *Id.* at 41.

The royalty rates calculated by Professor Willig for the foregoing categories are set forth in the figure below:

Figure 4: Royalty Rates for Outside Distributors (RESTRICTED)

[REDACTED]

Willig WDT fig.4.

Professor Willig testifies that in his Shapley Value Model, for the outside distributors identified in the above table, “[e]ach of their respective royalty rates are taken as they actually are or are expected to be.” Willig WDT ¶ 28. Accordingly, “the options of listening to broadcast AM/FM radio or not listening to music ... are modeled realistically as not producing any royalties for the record companies.” *Id.*; *see also* 8/5/20 Tr. 406 (Willig) (“I took those elements of opportunity costs from the market data as they are.”); *id.* at 378-79, 488-89 (Willig). SoundExchange notes that Professor Willig’s

treatment of “outside distributors,” including those that do not generate any royalties, such as AM/FM radio, is “[c]onsistent with the “fork in the road” approach taken by Professor Willig and adopted in *SDARS III*.” SX PFFCL ¶ 625 (citing *SDARS III*, 83 FR at 65328).

ii. Noninteractive Distributors’ Audience Sizes

In order to estimate the extent of diversion to alternative distribution methods and thus the value of the record companies’ opportunity cost in licensing to noninteractive services (in the hypothetical market), Professor Willig also needs to estimate audience sizes for the noninteractive distributors. He identifies “total numbers of plays per month” as an appropriate measure to use in order to gauge audience size. Willig WDT ¶ 43.

To make this calculation, Professor Willig relies on Pandora’s publicly reported financial projections to estimate its audience size, *see id.* ex. D.6, and he relies on SoundExchange’s royalty statements and other data to estimate Pandora’s *play share* of the noninteractive markets. These data indicate that Pandora which has approximately [REDACTED]% of the *play share* of the *ad-supported* noninteractive market and an [REDACTED]% play share of the *subscription* noninteractive market. *See id.*, app. D at ex. D.4. Professor Willig uses this *play share percentage* data as a proxy, to estimate Pandora’s *audience share percentage* of the noninteractive ad-supported and subscription markets. He further assumes that Pandora will have the same shares of these markets throughout the 2021-2025 rate period as it did over the recent 12-month period ending March 2019. Willig WDT ¶ 43.

Using these Pandora’s market shares, Professor Willig grosses up the Pandora audience size to reflect the total size of the noninteractive audience in these markets. By this method, he estimates that the *ad-supported* noninteractive market has an audience of [REDACTED], and that the *subscription* noninteractive market has an audience of [REDACTED]. *Id.* ¶ 44 & Fig. 5.

To adapt his audience size analysis to his opportunity cost analysis, Professor Willig converts the play count data into play-per user and play-per subscriber metrics.²³¹ Using Pandora’s public financial projections, *see id.* app. D, ex. D.6, he divides the projected average monthly play counts for Pandora’s two tiers (respectively, for the ad-supported and subscription tiers) by the projected number of active users (for the ad-supported tier) and by the projected number of subscribers (for the subscription tier). By this exercise, Professor Willig estimates that “users of Pandora’s ad-supported service are projected to listen to approximately [REDACTED] plays per month and subscribers to Pandora’s subscription noninteractive service (*i.e.*, Pandora Plus) are projected to listen to approximately [REDACTED] plays per month over the 2021-2025 period.” *Id.* ¶ 45.

iii. Estimating Opportunity Costs with Diversion Ratios

Professor Willig utilizes the dollar value of the previously discussed alternative distribution methods – “if a noninteractive distributor were no longer available in the marketplace” – to estimate the “opportunity cost that record companies experience by licensing to noninteractive distributors instead of only licensing to all the outside forms of music distribution” *Id.* ¶¶ 46, 47. More particularly, he multiplies these dollar values by the diversion ratios indicated by the survey work undertaken by another SoundExchange expert, Professor Gal Zauberman (the Zauberman Survey).²³² Professor Willig’s opportunity cost estimates for each alternative method of distribution are set forth in the figure below:

²³¹ Professor Willig converts this data into a per-user metric in order to apply it in conjunction with the per-user information derived from the survey results upon which he relies in the development of his opportunity cost estimates.

²³² *See* Zauberman WDT. Professor Zauberman’s survey testimony is discussed elsewhere in this Determination.

Figure 6: Diversion Ratios and Opportunity Cost (RESTRICTED)

			If Ad-Supported Noninteractive Were Unavailable	If Subscription Noninteractive Were Unavailable
Panel A Diversion to:	Subscription On Demand	(% of respondents buying new subscriptions)		
	SiriusXM	(% of respondents buying new subscriptions)		
	Ad-supported On Demand	(# of add'l plays per month per respondent)		
	CDs/Vinyl/Digital Downloads	(% of respondents becoming new purchasers)		
	Ad-supported Noninteractive Subscription Noninteractive	(# of add'l plays per month per respondent) (# of add'l plays per month per respondent)		
Panel B Royalty from:	Subscription On Demand	(\$ per subscriber per month)		
	SiriusXM	(\$ per subscriber per month)		
	Ad-supported On Demand	(\$ per play)		
	CDs/Vinyl/Digital Downloads	(\$ per subscriber per month)		
Panel C Opportunity Cost of Record Companies:	Subscription On Demand	(\$ per noninteractive user per month)		
	SiriusXM	(\$ per noninteractive user per month)		
	Ad-supported On Demand	(\$ per noninteractive user per month)		
	CDs/Vinyl/Digital Downloads	(\$ per noninteractive user per month)		
	Outside Distributor Subtotal	(\$ per noninteractive user per month)		
	Outside Distributor Subtotal	(\$ per play on noninteractive service)		

Willig WDT ¶ 47 & fig.6.²³³

iv. Record Company Play Shares in the Noninteractive Market

Because Professor Willig constructed his Shapley Value Model to identify the separate values attributable to each of the Majors and to his aggregation of Indies, he must identify their separate “play shares” in the noninteractive markets. To estimate these “play shares,” he relies on “the royalty statements that music streaming and video services provide to record companies when operating under directly negotiated license agreements.” *Id.* ¶ 48. More particularly, he analyzes the most recent monthly royalty statements available for the 12-month period ending March 2019, from: (i) *nonstatutory* streaming music and video services (with varying degrees of interactivity); (ii) statutory

²³³ Professor Willig provides a detailed explanation of how he incorporated Professor Zauberman’s survey results as inputs in his calculation of diversion ratios needed to estimate record company opportunity costs.

noninteractive services; and (iii) Pandora's and iHeart's noninteractive play counts ([REDACTED]).²³⁴

Professor Willig explains that these royalty statements set forth the total plays on each service in any given month, itemized by the record company that owned each copyrighted sound recording. He also states that he has no reason to believe these shares would be substantially different over the 2021-2025 rate period, compared to the data he had applied. *Id.*

From this data, Professor Willig calculates the relative proportions of plays of sound recordings whose copyrights are owned by, respectively, Sony, Warner, and Universal, as well as from his grouping of Indies. More specifically, he computes each Major's play share, and then computes the Indies' play share as equal to 100% minus the sum of the Majors' shares. *Id.* at ¶ 48 & app. D at ex. D.5.

Professor Willig summarized these play shares in the following figure:

Figure 7: Estimated Play Shares (RESTRICTED)

[REDACTED]

²³⁴ Even more granularly, Professor Willig evaluates all tiers of service (with varying degrees of interactivity) on the following services: Apple Music, Amazon Music Unlimited, Amazon Prime, Google Play, iHeart (both interactive and noninteractive tiers), Pandora (both interactive and noninteractive tiers), Napster, Spotify, Vevo, and YouTube. He notes that play share data from two other distribution methods – satellite via SiriusXM and physical retail and digital downloads – were “not available” to him. However, he testifies that he has “no reason to think the content of any of the record companies is played with more or less frequency on these distribution methods, when compared to the distribution methods (interactive and noninteractive streaming) for which I did have data.” Thus, he asserted that he had “no reason to believe this additional data would materially change” his play share estimates. Willig WDT ¶ 48 n.26.

v. Noninteractive Services' Fixed Costs and Marginal Profit Rates

As noted *supra*, Professor Willig's Shapley Value Model also requires data quantifying: (i) each record company's "fallback value"; and (ii) the surplus value brought by each of the negotiating parties to the notional Shapley market negotiations. With specific regard to the noninteractive services, Professor Willig states that the value they bring to the notional Shapley negotiations depends on their ability to generate profits, which subtract out from revenues variable costs, including the royalties noninteractive services pay for musical works (but not the sound recording royalties, which, to repeat, are the *outputs* of the Shapley Value Model). Willig WDT ¶ 49. To make this calculation, Professor Willig compiles categorical data relating to "fixed costs, variable or marginal costs and the associated marginal profit rates of noninteractive distributors" *Id.*

c. Professor Willig's Chosen Source of Financial Data

i. Financial Statements vs. Financial Projections

Professor Willig relies on the "Pandora Merger Proxy," dated December 20, 2018, and filed with the Securities and Exchange Commission (SEC), Trial Ex. 5045, that described the proposed merger (subsequently consummated) between Pandora and Sirius XM. *Id.* & app. D, ex. D.6 (p.3 therein). Professor Willig utilizes Pandora data exclusively to represent the noninteractive services because: (i) Pandora was the only noninteractive service for which he could find "forward-looking estimates" of the data that he required; and (ii) Pandora is the largest noninteractive distributor in the market, accounting (as noted *supra*) for more than [REDACTED]% of total plays in the noninteractive market. *Id.* & app. D at ex. D.4.

Perhaps in (correct) anticipation of the Services' rebuttal, Professor Willig explains in detail why he decides to rely on the "Pandora Merger Proxy" – which included predictions (what he characterized as "forward-looking estimates") of Pandora's

future financial performance, and which Pandora sent to its shareholders in connection with the then-proposed (and subsequently consummated) acquisition of Pandora by Sirius XM. More particularly, he explains why he favored these projections, rather than *older* data in Pandora's most recent financial statements contained in its 2017 Form 10-K (annual report) filed with the Securities & Exchange Commission (SEC), Trial Ex. 5043, or data *even more current than the proxy statement data* in Pandora's financial statements for the first half of 2019. Trial Ex. 5054. *See* Willig WDT, app. D (§ 2 therein).

Professor Willig acknowledges Pandora's "recent history of operating losses" (before and after Sirius XM's proposed acquisition of Pandora). However, he opines that such operating losses do not "accurately reflect expectations about the incremental value" that Pandora could bring to the notional Shapley Value negotiation concerning royalty rates for the 2021-2025 period. Willig WDT app. D (§ 2 therein). Rather, he states, it is more appropriate to rely on: (i) financial projections that undergird "the approximately \$3.5 billion purchase price paid by Sirius XM" to acquire Pandora; and (ii) Pandora's substantial market capitalization of approximately \$2.4 billion immediately prior to the announcement of the Sirius XM acquisition" *Id.* According to Professor Willig, these are *market*-based values, and therefore the data on which they were based – utilized by Pandora's investment bankers as an input into their merger fairness opinions – are more probative of Pandora's likely financial performance over the forthcoming 2021-2025 rate period. Willig WDT app. D (§§ 2-3 therein).

Although Professor Willig states a preference for projections as opposed to the most recent historical financial information, he also chose to ignore different financial projections created for Pandora by Sirius XM *after* it had acquired Pandora. He acknowledges that these newer financial projections "[REDACTED]." Regardless, as a basis for rejecting these projections, Professor Willig states: "I "understand" Pandora ...

produced [these] additional projections ... for these proceedings[.]” – *but he does not attribute his understanding to any source. Id.* ¶ 3 n.4.²³⁵

ii. Professor Willig’s Reliance on Merger “Scenario 2” Data

The Proxy Statement on which Professor Willig elects to rely contains two different sets of projections, denoted as “scenarios,” regarding Pandora’s predicted financial future. “Scenario 1a” projected a relatively lower value for Pandora, whereas “Scenario 2” projected a relatively higher value. Professor Willig elected to utilize the higher-value Scenario 2 projections, ignoring the lower-value Scenario 1a projections. He made this decision because he understood that Pandora’s investment bankers relied on the Scenario 2 projections to produce their valuation of Pandora in connection with the Sirius XM acquisition, and those projections were “in-line with the \$3.5 billion market price paid by Sirius XM to acquire [Pandora].” Willig WDT app. D, ¶ 3 & n.5.²³⁶ He notes that, by contrast, the Scenario 1a projections implied valuations substantially below this \$3.5 billion market price.” *Id.*

Using the higher-valued Scenario 2 projections, Professor Willig estimates Pandora’s annual fixed costs at \$397 million for its Pandora Free ad-supported service, and annual fixed costs of \$85 million for its Pandora Plus subscription service. He then converts these annual figures into monthly fixed costs. To convert these monthly *Pandora* fixed cost estimates into noninteractive service *industrywide* data, he grosses them up by dividing by Pandora’s market share (as he did when grossing up the audience

²³⁵ As discussed elsewhere in this Determination, Pandora vigorously denies the unattributed assertion that it created these newer projections, labeled “Long Run Scenarios” by Sirius XM, for the purpose of these proceedings.

²³⁶ Professor Shapiro concedes that the Scenario 2 data needs to be taken “seriously” and are “a big deal,” because they were included in the “merger proxy documents ... used as part of the acquisition.” 8/19/20 Tr. 2732-33 (Shapiro).

size). Through this method, Professor Willig estimates monthly fixed costs of \$40.4 million for ad-supported noninteractive services, and \$8.9 million for subscription noninteractive services. Willig WDT app. D, ¶ 4 & n.6.

Having identified and segregated the fixed costs, Professor Willig then utilizes the Scenario 2 data for his estimate of Pandora's variable costs.²³⁷ In this regard, Professor Willig also relies on other information, including a September 24, 2018 report by an investment banking firm (JMP Securities, engaged to analyze Sirius XM's acquisition of Pandora), that projected "content acquisition costs" for Pandora's three service tiers (Pandora Free, Pandora Plus and Pandora Premium). Willig WDT app. D at ex. D.6 (nn.8, 11 and 14 therein).

Generally, Professor Willig allocates Pandora's multi-tier variable costs on a per-tier basis proportionate to each tier's share of projected total (all-tier) revenue, through 2025, except where he identifies specific per tier costs. Specifically, these other identifiable variable costs include: (i) "Cost of Goods Sold" (including musical works royalties (performance right and mechanical rights royalties)); (ii) "Operating Expenses"; (iii) "Product Development Expenses"; (iv) "Sales and Marketing"; (v) "General and Administrative Expenses" and "Stock Based Compensation." Willig WDT app. D, ex. D.6 (at 3 therein).

Professor Willig also makes the following revenue-related assumptions regarding Pandora:²³⁸

- (i) revenue growth per subscriber annually from 2021-2025;

²³⁷ As noted *supra*, these variable costs are necessary inputs in the Shapley Value model because these are costs that must be subtracted from revenue in order to estimate the "surplus" that can be shared by the participants in the notional Shapley arrival orderings.

²³⁸ Revenue data is necessary in the Shapley Value Model because revenue minus variable costs yields the surplus that can be allocated among the negotiating parties according to their respective Shapley Values.

- (ii) monthly revenue per subscriber for Pandora Plus in 2020;
- (iii) annual revenue growth per subscriber for years 2021 to 2025;
- (iv) monthly revenue per subscriber for Pandora Plus in 2020; and
- (v) continued existence of the 2018 ad-supported and subscription noninteractive per-play royalty rates from 2021-2025 equal to the current statutory rates plus an annual 2% inflation rate.

Id. He bases his calculations of these five types of revenue information on “the assumptions accompanying the Proxy Scenario 2 projections and recent history which indicate that Pandora Premium is expected to grow faster than Pandora Plus.” *Id.*²³⁹

Based on the data upon which he relies, and the assumptions he makes in connection with that data, Professor Willig estimates an ad-supported marginal profit rate of \$0.0042 per play, and a subscription marginal profit rate of \$0.0048 per play. Willig WDT app. D, ex. D.6 (at 2 therein).²⁴⁰

iii. Professor Willig’s Caveat Regarding the Foregoing Cost and Profit Data

Although Professor Willig elects to rely in his corrected written direct testimony on the Scenario 2 data, he recognizes that the data sets he then possessed when drafting that direct testimony did not contain granular cost and revenue information regarding Pandora. Accordingly, the assumptions he was compelled to make, as itemized *supra*, were necessarily tentative in nature. Specifically, Professor Willig acknowledged:

[C]ertain key inputs to the Pandora projections were not disclosed in Pandora’s proxy statements (*e.g.*, projected ad-supported user and

²³⁹ Professor Willig also assumes that the number of ad-supported users for years 2021-2024 should be “calculated based on a liner [sic] user growth trend between the 2018 actual and 2025 projected figure. *Id.*

²⁴⁰ For the avoidance of confusion, the Judges point out that these figures are *not Professor Willig’s proposed royalty rates*, but rather his estimated marginal profit rates. His calculation of royalty rates is discussed *infra*.

subscriber counts, projected plays, and a breakdown of subscription revenue into its underlying Pandora Plus and Pandora Premium component parts). Accordingly, certain allocation assumptions were required to estimate key parameters from Pandora's projected financial information. Estimates derived from these projections may require amendment following the completion of discovery.

* * *

The Pandora projections on which these estimates are based do not disclose certain key inputs that were used to create the projections. For instance, the projections do not include a breakdown of subscription revenue into the portions related to its Pandora Plus noninteractive and Pandora Premium on-demand services, respectively, and therefore require an allocation assumption to exclude Pandora Premium revenue and costs from the analysis. Moreover, the projections do not include the projected subscriber counts, active user counts, and play counts underlying the projections, requiring these figures to be derived so that profit rates can be computed. Accordingly, the assumptions required to estimate key parameters for use in my Shapley Value model may need to be updated following the completion of discovery.

Willig WDT ¶ 50 n.30, app. D at D-3. Professor Willig did not amend his direct testimony to update these “key parameters.”

In *Pandora's* rebuttal testimony, it criticizes Professor Willig's assumptions, and demonstrates that the more granular data provided an accurate description of Pandora's economic condition that served as the basis for the Scenario 2 projections on which Professor Willig elected to rely. *See* Trial Ex. 4109 (WRT of Jason Ryan) (Ryan WRT); Shapiro WRT (applying Mr. Ryan's economic data).

Later, in his written *rebuttal* testimony, Professor Willig utilizes the more granular economic data underlying the Scenario 2 projections to amend his direct testimony by substituting that data for the assumptions he had made in his direct testimony. Specifically, he testified as follows regarding the “updates” he made in his rebuttal testimony (at Appendix L):

These revised profit rate estimates adopt certain of Professor Shapiro's cost allocation assumptions, his definition of variable costs, and make use of further details relating to the projections publicly disclosed in Pandora's merger proxy ... (including subscriber counts, Pandora Plus revenues, advertising hours, and operating expense synergies).

Willig WRT ¶ 75 n.138.

Further, Professor Willig essentially adopted the analysis undertaken by Pandora's Vice President of Financial Planning and Analysis, Jason Ryan, regarding the allocation of advertising revenues; projected growth of subscription revenue; classification of certain sales and marketing expenses; classification of product development costs; and projected number of users, subscribers and plays. *See* 8/5/20 Tr. 525 (Willig) ("[W]hen you check the numbers that [Mr. Ryan] says are right against the numbers I use in my rebuttal report, they are exactly the same."); *see also* Willig WRT app. L at 1, 3-4 & nn.2-4, 11 55-58 & 72-74; 8/5/20 Tr. 361-62, 520-25, 527-528 (Willig); SX PFFCL ¶¶ 669-674 (noting that Professor Willig's testimony, mooted many of the issues raised by Mr. Ryan and Professor Shapiro). Accordingly, the Judges adopt Mr. Ryan's analysis of the more granular cost and revenue data necessary to generate Pandora's profit margins on its subscription and ad-supported services. Additionally, the Judges find that Mr. Ryan, as a financial executive at Pandora, is a more competent witness to make the necessary categorizations and allocations of revenue and costs than Professor Willig.²⁴¹

²⁴¹ Thus, the Judges do not rely on Professor Willig's assertion that the more granular revenue and cost information did require him to materially change his royalty rate calculations. *Id.* More particularly, Pandora asserts that Professor Willig's analysis is still erroneous in two respects because he: (1) misallocates product development costs across the ad-supported and Pandora Plus services by applying revenue proportions; and (2) fails to deduct non-music revenue from his calculation of Pandora's margin. Services PFFCL ¶¶ 277-286 (and record citations therein). These disputes do not require extended analysis. Suffice it to say, with regard to the first issue, the Judges repeat their finding that Professor Willig's attempt – for the first time in rebuttal testimony – to justify his allocation of product development costs across Pandora's services, is less credible than the analyses made by Mr. Ryan, who is a *fact witness* with direct knowledge of these details regarding Pandora's product development costs. *However*, with

d. Professor Willig's Calculation of the Record Companies' Opportunity

Costs

As noted *supra*, Professor Willig assumes that each of the three Majors in his Shapley Value Model provides a “Must Have” repertoire for a noninteractive service. Willig WDT app. C at C-1 (¶ 1 therein). Therefore, his modeling assumes that “only when all three [Majors] are present in a coalition can the [noninteractive service] begin making profits.” *Id.* at C-3 (¶ 5 therein). This means that “in any other case” – including when a noninteractive service obtains licenses from only one or two Majors – Professor Willig’s Shapley Value Model assumes that the noninteractive service “cannot operate.” *Id.* at C-5 (¶ 8 therein).

Professor Willig acknowledges that the assumed “Must Have” status of each Major generates “complementary oligopoly power” in the market. However, he understands that the Judges’ determination in a prior proceeding, *Phonorecords III*, “credited a Shapley Value analysis as one way of addressing concerns about complementary oligopoly power [because] the analysis performed in the proceeding

regard to the second numbered issue above, Professor Willig explained persuasively that Pandora’s criticism of his treatment of non-music revenue did not impact the royalty rate he calculated, because he made his profit calculations on a per-play basis that was unaffected by the treatment of non-music revenue, in that “non-music revenue and non-music listening travel together in roughly equal proportion,” with each representing approximately [REDACTED]% of revenue and listening.” SX RPFCL (to Services) ¶ 284 (and record citations therein). Moreover, because the amount of listening and revenue at issue in this allocation is only [REDACTED]% of each metric, the allocation of this revenue would have only a *de minimis* impact on the royalty rate ultimately estimated by Professor Willig’s Shapley Value Model.

eliminated this ‘walk away’ power by valuing all possible orderings of the players’ arrivals.” Willig WDT ¶ 14 (quoting *Phonorecords III*, 84 FR at 1933 n.69).²⁴²

e. The Noninteractive Services’ Shapley Values Derived by Professor Willig

By inserting the data inputs, discussed above,²⁴³ into the Shapley Value formulas,²⁴⁴ Professor Willig derives Shapley Values and corresponding royalty rates for ad-supported and subscription noninteractive services, respectively. *Id.* at 51 & fig.9.

These results are set forth below:

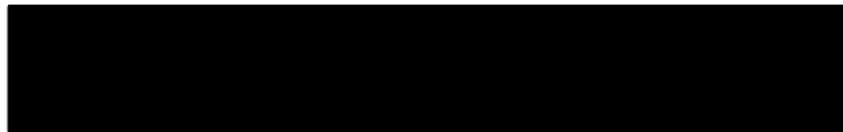
²⁴² The Judges again discuss the issue of whether the repertoire of each Major is a “Must Have” *infra*, in connection with Pandora’s assertion that its Label Suppression Experiments (LSEs) demonstrate that no one Major’s repertoire is a “Must Have.”

²⁴³ *See also* Willig WDT app. D.

²⁴⁴ *See* Willig WDT app. C.

Figure 9: Estimated Shapley Values and Royalty Rates for Noninteractive Distributors³¹
(amounts are monthly except per play rates) (RESTRICTED)

	Ad-Supported Noninteractive	Subscription Noninteractive
Projected Profits (before royalties)		
\$ millions		
\$/Play		
\$/Subscriber		
Total Opportunity Cost		
\$ millions		
\$/Play		
\$/Subscriber		
Shapley Value		
\$ millions		
\$/Play		
\$/Subscriber		
Royalties		
\$ millions		
\$/Play	0.00297	0.00312
\$/Subscriber	N/M	2.04



Because the royalty rates derived by Professor Willig are based in part on the diversion ratio results obtained from the Zauberman Survey, *i.e.*, a survey of a sample from the larger population, the royalty rates are statistically inexact. Accordingly, Professor Willig calculates a confidence interval for his results, utilizing a “bootstrap procedure”²⁴⁵ that produces a 95 percent confidence interval. This confidence interval establishes ranges for the royalties from \$0.00290 to \$0.00299 for the ad-supported noninteractive royalty rate and of \$0.00299 to \$0.00316 for the subscription noninteractive royalty rate. Willig WDT ¶ 51 & app. E.

²⁴⁵ The Judges have previously described the “bootstrap” procedure in the survey context as “a sampling of the survey respondents [that is] itself randomly selected and thereby create[s] a confidence interval around each of the reported survey results” – in this case the entirety of the Zauberman Survey. *SDARS III*, 83 Fed. Reg. at 65232 n.90. There is no challenge by any of SoundExchange’s adverse parties to this process.

Professor Willig emphasizes and explains several features of his results. First, he points out that “the resulting Shapley Value for the ad-supported noninteractive [service] is near zero.” *Id.* ¶ 51. The reason for this near-zero Shapley Value, he opines, is that “the record companies’ opportunity costs are high relative to the total projected profits of [the ad-supported noninteractive services].” *Id.* Stating this point in commercial terms, Professor Willig explains that it reflects the alleged fact that “the vast majority of those profits are necessary to compensate the record companies for the ad-supported noninteractive distributors’ cannibalization of listeners that would otherwise consume music via other compensatory forms of music distribution.” *Id.*²⁴⁶

f. The Royalty Rates Derived from Professor Willig’s Shapley Value Model

Based on the foregoing analysis, and as stated at the outset of this description of Professor Willig’s modeling, he opines that his Shapley Value Model generates a royalty rate for ad-supported noninteractive services of \$0.0028 per play for 2021 and for subscription noninteractive services of \$0.0030 per play for 2021.²⁴⁷

²⁴⁶ Professor Willig also finds support for these high opportunity costs and royalties in: (i) Pandora documents that he understands [REDACTED]; and (ii) testimony from record company witnesses that [REDACTED]. *See* Willig WDT ¶¶ 52-54.

²⁴⁷ Professor Willig also uses a different set of survey results as a check on his Shapley Values and royalty rates. Specifically, he utilizes data from market research conducted by Edison Research – known as the “Share of Ear” study – that analyzes the share of time Americans spend listening to all different forms of music distribution. He concludes that this alternative data set confirms the royalty rates he derived from the Zauberman Survey results. Willig WDT ¶¶ 56-60 & ex.F. The Judges analyze this alternative approach in their discussion of the Services’ criticisms of Professor Willig’s Shapley Value modeling, *infra* section IV.C.1.g.

g. The Services' Criticisms of Professor Willig's Shapley Value Model

Approach and the Judges' Analysis and Findings

i. Is Professor Willig's Shapley Value Modeling Appropriate for Setting Noninteractive Rates?

(A) Professor Willig's Shapley Value Model is Inconsistent with the Shapley Modeling in *Phonorecords III* and thus Fails to Generate Effectively Competitive Rates

Professor Willig's Shapley Value Model – like all Shapley modeling – incorporates all potential “arrival orderings.” Therefore, unlike in the actual market, the modeling does not include any scenario in which a Major record company can leverage a threat to “Walk-Away” from negotiations into a royalty rate that includes the effect of its complementary oligopoly status. As noted *supra*, Professor Willig – relying on *Phonorecords III* – thus opines that a Shapley Value analysis is “one way of addressing concerns about complementary oligopoly power” Willig WDT ¶ 14. Therefore, in his opinion his Shapley Value Model is “an appropriate approach for assessing rates that

Additionally, Professor Willig tested the sensitivity of his Shapley Value model using a Nash-in-Nash (N-I-N) bargaining framework, another approach for modeling a multi-party negotiation. Willig WDT ¶¶ 61-67; 8/6/20 Tr. 738-39 (Willig). Under that framework, each potential negotiating record company/noninteractive service pair reaches a “Nash” bargain in which the record company receives its fallback value and each counterparty receives one half of the surplus created by the deal. Willig WDT ¶ 62. In these Nash-in-Nash (N-I-N) negotiations, the parties assume that all other pairs of parties have reached (or will reach) an equilibrium agreement. *Id.* A solution is reached when there is no negotiating pair with an incentive to change its agreement. *See id.* ¶¶ 65-66 & fig.11, app. G. His N-I-N model produces royalty rates similar to those obtained from Professor Willig's Shapley Value model – royalty rates for 2021 of \$0.0030 per play for ad-supported noninteractive services and \$0.0030 per play for subscription noninteractive services. Willig WRT ¶ 82 n.147; 8/6/20 Tr. 739 (Willig).

would be negotiated in the hypothetical marketplace for noninteractive webcasting.” *Id.* ¶

24.

However, notwithstanding the fact that Shapley modeling includes all possible “arrival orderings,” expert economic witnesses for Pandora and Google, respectively, argue that Professor Willig’s Shapley Value Model nonetheless incorporates complementary oligopoly power. *See* Shapiro WRT at 52, 57 (Jan. 10, 2020); Peterson WRT ¶¶ 82, 85, 100 n.103 (Jan. 10, 2020). As a second criticism, Professor Shapiro further asserts that Professor Willig misapplies the Shapley Value analysis in *Phonorecords III*. Shapiro WRT at 57.

Dr. Peterson summarizes his first criticism and that of Professor Shapiro regarding the purported presence of a complementary oligopoly effect in Professor Willig’s Shapley Value Model:

Professor Willig explicitly assumes that the major record labels are essential to a noninteractive streaming service. This implies that a single label can shut down the service, which allows the label to guarantee itself a high value or monetary payoff when acting alone.

* * *

[Because] Professor Willig’s Shapley Value model explicitly models the major record labels as being essential ... each [Major] can individually extract the value that a monopolist would extract from the streaming service or distributor. In the Shapley Value model, this set up allows the essential labels to extract the monopoly value of their recordings from the streaming service

Peterson WRT ¶ 87.

There is no dispute that in Professor Willig’s Shapley Value Model – when the last arriving party is assumed to be a “Must Have” Major – that this last arriving Major will generate the *entire* value generated by noninteractive streaming. *That monopoly value is repeated for each of the three Majors when it is the last to arrive in a Shapley ordering.* Thus, when the modeling assumes the presence of complementary oligopolists – as does Professor Willig’s modeling – it preserves a substantial measure of the Majors’

“Must Have” power and translates it into higher shares of the Shapley surplus and, ultimately, higher royalty rates.

The validity of this criticism is made obvious by the following simple example, which reveals the different Shapley Values that arise even though all arrival orderings are present in a Shapley model:²⁴⁸

Assume the total Shapley Surplus = 12

Assume 2 Majors (“1” & “2”) with “Must Have” repertoires (*i.e.*, complementary oligopolists)

Assume 1 Noninteractive Service, “S”

Arrival Orderings	Contribution by S	Contribution by #1	Contribution by #2
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²⁴⁸ The following examples assume only one service, in order for the example to be tractable and simply to demonstrate that, *ceteris paribus*, changing the number of licensor record companies alone will change the relative Shapley Values and resulting royalties. Cf. *Phonorecords III*, 84 Fed. Reg. at 1950 n.119 (discussing the practical value of attempting to model effective competition by limiting the number of “arrival orderings” via a reduction in the number of licensees rather than an increase in the number of licensors). The Judges are not suggesting that an appropriate Shapley Value Model would necessarily contain only a single service, unless supported by the marketplace facts.

1, 2, S	12	0	0
2, 1, S	12	0	0
S, 1, 2	0	0	12
1, S, 2	0	0	12
S, 2, 1	0	12	0
2, S, 1	0	12	0

Shapley Value for S = 4 (24/6); Shapley Value for #1 = 4 (24/6); Shapley Value for #2 = 4 (24/6)

So, in a Shapley Value model *with complementary oligopoly*, Service S pays 8/12 of surplus (67%) toward royalties to Record Companies #1 and #2.

But, compare below the royalty payment by the service *if there was no complementary oligopoly structure*, and instead one record company (#1) owned all the copyrights for sound recordings:

Arrival Orderings	Contribution by S	Contribution by #1
1, S	12	0
S, 1	0	12

Shapley Value for S = 6 (12/2); Shapley Value for #1 = 6 (12/2)

So, in the Shapley Model *with monopoly instead of complementary oligopoly*, Service S pays only 6/12 of surplus (50%) toward royalties to Record Companies #1 and #2, substantially less than if a complementary oligopoly exists.

Alternatively, the Judges note that, if the market structure contains two *substitute* oligopolies that compete with each other (rather than *complementary* oligopolies) and each is able to satisfy 50% of market demand, the Shapley modeling would look as follows:

Arrival Orderings	Contribution by S	Contribution by #1	Contribution by #2
1, 2, S	12	0	0
2, 1, S	12	0	0
S, 1, 2	0	6	6
1, S, 2	6	0	6
S, 2, 1	0	6	6
2, S, 1	6	6	0

Shapley Value for S = 6 (36/6); Shapley Value for #1 = 3 (18/6); Shapley Value for #2 = 3 (18/6)

So, in the Shapley Model *with substitute competing oligopolies instead of complementary oligopoly*, Service S pays only 6/12 of surplus (50%) toward royalties to Record Companies #1 and #2, again substantially less than if a complementary oligopoly exists.²⁴⁹

²⁴⁹ The purpose of these examples is to demonstrate the significant limitations of a Shapley Value Model that simply takes as a given the complementary oligopoly structure of the market being modeled. Monopolies or oligopolies may well exist because of their “efficiencies and economies of scale and/or their superior operations.” *Web IV*, 81 Fed. Reg. at 26368. Whether any such entity utilizes such power in a manner that generates rates that are inconsistent with the workings of an effectively competitive market is a separate issue not addressed in the application of the Shapley Value Model in this proceeding. *See Web IV*, 81 Fed. Reg. at 26335 (distinguishing between “[c]omplementary oligopoly’ power exercised by the Majors designed to thwart price competition and thus inconsistent with an ‘effectively competitive market,’ [and] the Majors’ non-complementary oligopolistic structure not proven to be the consequence of anticompetitive acts or the cause of anticompetitive results.”). The narrow point here is that the *complementary* oligopolistic market structure is not well-modeled via the Shapley approach, without an adjustment to offset the complementarity of the “Must Have” repertoires, as was done by Professor Marx in *Phonorecords III* and adopted by the majority in *Phonorecords III* in its application of the Shapley approach.

In sum, these examples demonstrate how Shapley Value modeling is sensitive to the number of participants, the number of orderings, substitutability and perfect complementarity of the services, *even though in each case all arrival orderings are generated by the Shapley modeling.*

With regard to the second criticism, Professor Shapiro claims:

[T]he Shapley Value models used in *Phonorecords III* explicitly avoided complementary oligopoly power among separate copyright holders for each set of rights by removing the oligopoly. Professor Willig does *not* follow that approach to removing complementary oligopoly power among the major record companies in his Shapley Value model. As a result, for the very reasons given by the Judges in *Phonorecords III*, Professor Willig's model gives additional returns to the major record companies by endowing them with complementary oligopoly power.

Shapiro WRT at 57.

In this regard, in *Phonorecords III*, the Judges analyzed two Shapley Value models and one “Shapley-inspired” model in the same context of perfect complements/complementary oligopoly. Ultimately, the Judges combined elements of all three approaches, but, importantly here, they credited the Shapley Value model of Professor Leslie Marx for the purpose of calculating the total amount of royalties. In determining that total, Professor Marx first equalized the number of licensees in order to reduce the complementary oligopoly effect that is embodied in a Shapley Value approach, even though the use of Shapley “arrival orderings” eliminates the complementary oligopolists’ “walk-away” (hold-out”) power. In this manner, she intentionally altered the number of arrival orderings in which one of the complementary oligopolists provided the entirety of the additional value. *Phonorecords III*, 84 FR at 1948-50 (“Professor Marx ... offset the concentrated market power that the rightsholders possess, *separate and apart from any holdout power*, which the Shapley ordering

algorithm would address ... *address[ing] an issue—market power—that the Shapley Analysis does not address.*”).²⁵⁰

Professor Willig’s Shapley Value Model specifications deviate in another important manner from those in the Shapley modeling in *Phonorecords III*. In that case, all the economists’ Shapley modeling *aggregated the record companies as a single entity*, eliminating their complementary oligopoly power. Moreover, one of the economists who utilized Shapley Value modeling in that case, Professor Leslie Marx, utilized two different market structure models – her “baseline” model in which these two perfectly complementary (“Must Have”) rights (for sound recordings and musical works) were assumed to be owned by a single collective, and her “alternative” model in which these complementary rights were assumed owned by two separate entities. She used these two models (like the Judges use their examples above) as a pedagogical demonstration of how the fragmentation of ownership of complementary rights leads to higher and more inefficient royalty rates, *even in Shapely modeling that includes (by*

²⁵⁰ In this regard, it should be noted that the *Phonorecords III* dissent was in accord with the Majority. The dissenting opinion pointed to expert testimony and evidence making clear that there is a distinction between: (1) the “abuse of market power” that arises when a “Must Have” licensor holds-out (or threatens to hold out) during negotiations, in order to earn economic rents arising from the fragmentation of ownership of “Must Have” inputs; and (2) the presence of existing market power disparities that may otherwise be implicit in Shapley Value modeling. The former “abuse” of market power is indeed ameliorated by the Shapley Value approach, whereas a complementary oligopoly effect inconsistent with effective competition can only be mitigated in Shapley Value modeling if the modeler adjusts for that market power disparity. *See Phonorecords III*, 84 Fed. Reg. 2023 & n.342 (dissenting opinion) (applying consistent testimony from, and evidence regarding, four economic expert witnesses, Professors Watt, Marx, Katz and Gans).

definition) all possible arrival orderings.²⁵¹ See *Phonorecords III*, 83 FR at 2022

(dissenting opinion) (Professor Marx “made this adjustment to offset the concentrated market power that the rights holders possess ... *that the Shapley value approach does not address.*”). By contrast, Professor Willig here models each Major as a separate “Must Have,” which *incorporates the complementary oligopolists’ pricing power, notwithstanding the inclusion of all arrival orderings.*

Professor Willig did not address this aspect of *Phonorecords III*, either in his WDT or WRT. At the hearing, the Judges asked Professor Willig if he had read the *Phonorecords III Determination* before he wrote those written testimonies, and he responded: “Portions of it, yes [but] I must confess, not the whole thing.” 8/25/20 Tr. 3863 (Willig). (In both of his written testimonies, though, he identified the *Phonorecords III Determination* as a document upon which he relied, without noting that he did not read it in its entirety. Willig WDT, app. B at B-2; Willig WRT, app. I. at I-1.).²⁵²

The Judges then asked Professor Willig if he had read the portions regarding “the distinction between holdout power and market power ... that was ... actually adopted by way of adjustments by the majority ... in *Phonorecords III*, [or] discuss that *Phonorecords III* issue in either of your written testimonies?” 8/25/20 Tr. 3864 (Willig).

²⁵¹ That is, Professor Marx demonstrated precisely what the Judges have shown in the example in the text, *supra*.

²⁵² Professor Willig was also unable to recall, and did not address, an article on which the Judges expressly relied in *Web IV* for the proposition that “even economists quite unwilling to assume that a given monopoly or oligopoly structure is inefficient and anticompetitive bristle at the idea that supranormal pricing arising from a complementary oligopoly is reflective of a well-functioning competitive market. *Web IV*, 81 Fed. Reg. at 26368 (citing Francesco Parisi & Ben DePoorter, *The Market for Intellectual Property: The Case of Complementary Oligopoly*, in *THE ECONOMICS OF COPYRIGHTS: DEVELOPMENTS IN RESEARCH AND ANALYSIS* (W. Gordon and R. Watt eds. 2003)).

Professor Willig's response made it clear that he had not addressed that specific issue. Rather, he provided a discursive answer in which he repeated that his Shapley Value Model "has *at least* a prominent virtue *on this very subject that you are mentioning* of eliminating any special hold out power, or market power *that derives from the ability to be a holdout*" 8/25/20 Tr. 3864-65 (Willig) (emphasis added). But the usefulness of the Shapley Value approach in eliminating "hold out power" was *not* "the very subject" of the Judges' question. Rather, their inquiry was whether Professor Willig had addressed the issue in *Phonorecords III* as to whether the "arrival orderings" themselves embedded the complementary oligopoly power of the Majors.

Continuing his response to the Judges' inquiry, Professor Willig further stated that it is necessary to "to distinguish between the holdout power and the value that a party to the negotiations brings to the enterprise. And if one of the parties is a must-have, because it's so important, well, it shouldn't be denied the value that it brings ... you don't want to strip away the value because that's part of the marketplace and part of the incentives to the parties to do what they need to do to provide that value." 8/25/20 Tr. 3865 (Willig).

But, this too does not resolve the issue of whether the arrival orderings in his Shapley Value model embed complementary oligopoly power into his Shapley Values and thus, ultimately, inflate the royalty rates. Moreover, his answer essentially states that a "must have" licensor should retain the value of that status, even though it is an artifact of the fragmented ownership of the "must have" nature of their repertoires, leading to a consequence where the Shapley Value modeling would provide the Majors with the value of this artifact, beyond the considerable value of their repertoires. *See Web IV*, 81 FR at 26368 (noting that eliminating the "must have" power of complementary oligopoly does not "diminish the firm-specific monopoly value of each Major's repertoire taken as a whole."). Moreover, the perfect complementarity generates market consequences that are even worse than monopoly. *See Web IV*, 81 FR at 26342 (relying on the "logic first

identified by Antoine Cournot in 1838, *firms offering complementary products tend to set higher prices than would even a monopoly seller*) (emphasis added); see also *id.* at 26368 & n.142); 8/18/20 Tr. 2642-43 (Shapiro); 8/25/20 Tr. 3655-56 (Peterson).²⁵³

Accordingly, the Judges agree with Professor Shapiro's criticism of Professor Willig's approach for failing to "remov[e] complementary oligopoly power among the major record companies in his Shapley Value model," and "for the very reasons ... in *Phonorecords III*, giv[ing] additional returns to the major record companies by endowing them with complementary oligopoly power." Shapiro WRT at 57.²⁵⁴

ii. Did Professor Willig Correctly Reject the 2019 "Long Range Scenario" (LRS) for Pandora Prepared by Sirius XM?

Pandora also criticizes Professor Willig's decision to ignore the data contained in Sirius XM's LRS, Trial Ex. 4010, in his calculation of Pandora's profit margins over the

²⁵³ Professor Willig did address the type of adjustment made by Professor Marx to her Shapley Value model in *Phonorecords III*, in response to a general question from the Judges. He testified as follows:

I think it would matter if somehow the majors were collapsed into a single major. That would affect the results, but in a way that would deviate from the features of the marketplace that are realistic and important.

8/5/20 Tr. 323 (Willig). However, the Judges find that changing the structure of the licensor-side of the market to eliminate complementary oligopoly effects is necessary. Although the Judges do not dispute Professor Willig's characterization of that complementary oligopoly power as "realistic" or "important" in an *actual* market for the licensing of noninteractive services, they find, as they did in *Web IV*, that a rate formula incorporating complementary oligopoly power is antithetical to an effectively competitive rate.

²⁵⁴ To be clear, the Judges do not disagree with Professor Willig as to the "Must Have" status of each Major as a "Must Have." Rather, as noted in the Judges' prior discussion in this Determination regarding "effective competition," they continue to find that an appropriate downward adjustment must be made to royalty rates that reflect the effects of a complementary oligopoly market structure. The Judges consider *infra* whether the record provides a basis for making the necessary effective competition adjustment to Professor Willig's Shapley Value Model.

2021-2025 rate period. Although Professor Willig contends (with no attribution) that this LRS was prepared solely for this proceeding, Pandora’s Vice President of Financial Planning and Analysis, Jason Ryan, describes the LRS as a document “generated by Sirius XM *in the ordinary course of business*,” and is intended, *inter alia*, to “guide management in the preparation of its operating budget and business plan for the next year.” Ryan WRT ¶ 36 (emphasis added). According to Mr. Ryan, the budgets created through Sirius XM’s LRS process “are also a tool that the Board of Directors of Sirius XM uses throughout the year to gauge the health of the business and at the end of the year when assessing performance-based compensation of executive officers and employees.” *Id.* More particularly, Mr. Ryan explains that the LRS process proceeds in the following manner:

The [REDACTED] flow from our reasonable efforts to plan and predict the trajectory (contraction or growth) of the business.

Id. ¶ 38.

Mr. Ryan’s testimony is uncontroverted on this point. Further, there is no record evidence to support Professor Willig’s “understanding” that Sirius XM’s purpose in creating this particular LRS was to use it as evidence in this proceeding. *See* Willig WDT app. D ¶ 3 n.4. There is also no evidence to suggest that Sirius XM manipulated the financial information in this June 2019 LRS in order to affect the financial analyses undertaken in this proceeding.²⁵⁵

²⁵⁵ When asked by the Judges why he included this language in his WDT, Professor Willig testified:

I'm *not sure* that that's what I had in mind with those words. Rather, that it had been produced recently relative to the timing of the submission by me, and it was produced for these proceedings, and I didn't mean, *as I recall, unless there's something that I'm forgetting*, which is always possible, that the LRS data were actually created just for these proceedings as opposed to produced for these hearings.... *I may have had some evidence of the specialization of the purpose, but I don't recall that now.* But what I surely meant was, at least, that the production was for these hearings. And I'm well aware that LRS is something that Sirius had been preparing for its own purposes going back years So *I don't remember whether it was really produced specifically for these purposes*

Nonetheless, as noted *supra*, Professor Willig independently justifies his reliance on the Scenario 2 merger financial data on the fact that “Pandora’s investment bankers prepared discounted cash flow valuation analyses using these Scenario 2 projections, which produced valuations in-line with the \$3.5 billion market price paid by Sirius XM to acquire the company.” *Id.* Accordingly, the Judges must examine *on its own merits* the Scenario 2 data upon which Professor Willig relies to compute Pandora’s profit margins.

Professor Shapiro takes issue with Professor Willig’s claim that the price paid to Pandora shareholders by Sirius XM is supported by the Scenario 2 financial projections, noting that the acquisition price was determined “in part by synergies not included in Scenario 2 which considers Pandora as a standalone company.” Consequently, Professor Shapiro asserts that the “discounted cash flow” set forth in the Scenario 2 materials does not generate the acquisition price paid by Sirius XM. Shapiro WRT at 72-73.

The Judges find that Professor Shapiro’s criticism neither compromises the probative value of the Scenario 2 data nor Professor Willig’s reliance on it to support his Shapley Value Model. Although the “discounted cash flow” contained in the Scenario 2 materials, standing alone, may not generate the actual acquisition price paid by Sirius XM, Professor Shapiro does not dispute that such information was relied upon by the investment bankers in their development of an appropriate price—one that ultimately was accepted by Pandora shareholders. That purchase price is not disconnected from projections based on Pandora’s economic condition as of the date of the acquisition.²⁵⁶

8/5/20 Tr. 366-67 (Willig) (emphasis added). The Judges find this response equivocal at best, and incomprehensible at worst.

²⁵⁶ Professor Shapiro does not assert that the inclusion of synergistic value necessarily disqualifies financial projections as useful inputs into a Shapley model in this proceeding. In fact, he points out that the alternative and subsequent financial projection in the LRS, on which he relies, *explicitly* includes “anticipated synergies” in its financial projections. Shapiro WRT at 73.

Moreover, the price that willing sellers (here, Pandora shareholders) agree to pay to a willing buyer (here, Sirius XM), reflects a price established in *a* market – the market for corporate control. *See* Henry G. Manne, *Mergers and the Market for Corporate Control*, 73 J. POL. ECON. 110, 112 (1965) (“[C]ontrol of corporations may constitute a valuable asset” and is purchased and sold in “an active market for corporate control...”). The fact that the purchase price incorporates not only Pandora’s capitalized discounted cash flow, but also the synergistic value assigned to Pandora by the investment banks and Sirius XM, upon the consummation of the merger, does not negate the evidentiary usefulness of the financial data underlying that acquisition price. A company’s shares, like any assets, are appropriately valued at their highest and best use. Given that the acquisition of Pandora by Sirius XM indeed occurred, it is reasonable to conclude that Pandora’s highest and best use, in terms of market value, was as a division of Sirius XM.

Accordingly, the Judges find that Professor Willig’s reliance on Scenario 2 data was reasonable.²⁵⁷

iii. Professor Shapiro’s Calculation of Scenario 2 “Marginal Profit” after applying the Foregoing Criticisms

Professor Shapiro combines the foregoing criticisms based on Professor Willig’s Shapley Value Model data inputs into a recalculation of marginal profits that is otherwise consistent with Professor Willig’s Scenario 2 approach. The recalculation with regard to the *subscription service* is set forth in Figure 6 of Shapiro WRT at 47, and the recalculation with regard to the ad-supported service is set forth in Figure 7 of Shapiro WRT at 48. Each figure is reproduced below:

²⁵⁷ And as explained *infra*, the Judges’ adoption of certain of Professor Shapiro’s itemized critiques of Professor Willig’s data applications essentially equates the rates generated by Professor Willig’s reliance on the Scenario 2 data and Professor Shapiro’s reliance on LRS data.

Figure 6: Pandora Projected Margins: Pandora Plus Subscription Service [RESTRICED]

[REDACTED]

Figure 6 shows that substituting Professor Shapiro's changes for Professor Willig's original estimated data inputs results in a significantly lower per-performance margin at Pandora Plus, the subscription service. Shapiro WRT at 47. (As noted *supra*, Professor Willig also made most of these adjustments in his WRT.) Specifically, whereas Professor Willig calculated a per-performance margin of \$0.0048, Professor Shapiro re-calculated a per-performance margin of \$[REDACTED].²⁵⁸

Figure 7: Pandora Projected Margins: Advertising-Supported Service [RESTRICED]

[REDACTED]

Figure 7 shows that substituting Professor Shapiro's changes for Professor Willig's original estimated data inputs results in a significantly lower per-performance margin at Pandora Plus, the subscription service. Shapiro WRT at 46-47. (As noted *supra*, Professor Willig also made most of these adjustments in his WRT.) Specifically, whereas Professor Willig calculated a per-performance margin of \$0.0042, Professor Shapiro re-calculated a per-performance margin of \$[REDACTED].²⁵⁹

²⁵⁸The impact of these adjustments on the royalty estimates generated by Professor Willig's Shapley Value Model, together with the impact of the adjustments to Professor Willig's opportunity cost calculations, is set forth *infra*.

²⁵⁹ The impact of these adjustments on the royalty estimates generated by Professor Willig's Shapley Value Model, together with the impact of the adjustments to Professor Willig's opportunity cost calculations, is set forth *infra*. The Judges also note that Figures 6 & 7 show that Professor Shapiro's adjustments and

The Judges adopt these adjustments to Professor Willig's profit margin calculations in his Shapley Value Model.²⁶⁰

iv. Alleged Errors in Professor Willig's Scenario 2 Opportunity Cost Calculations

Professor Shapiro alleges that Professor Willig made several errors in his calculation of opportunity costs that resulted in an overestimation of the opportunity costs

corrections to the original profit margins in Professor Willig's Shapley Value Model result in Scenario 2 profit margins that are essentially identical to the profit margins estimated by Professor Shapiro in the "alternate forecasts" based on the LRS and Merger Proxy Scenario 1A. Shapiro WRT, Figs. 6 & 7 (last two columns). Accordingly, there is no necessity to consider those alternatives as necessary to establish different royalty rates in this proceeding.

²⁶⁰ The Judges explain in text accompanying note 241, *supra*, that they rely on Mr. Ryan's categorizations and allocations of revenues and costs because of his competency with regard to these issues, given his role as a financial executive, and because of the Judges' perception of his credibility as a witness. By contrast, SoundExchange did not proffer an accounting or financial expert to testify regarding these categorization and allocation issues, leaving these issues to an economist, Professor Willig. Although Professor Willig is without question an esteemed economist, the Judges find that he is not nearly as competent as Mr. Ryan to give testimony regarding Pandora's financial and accounting issues. *See also* 8/5/20 Tr. 306-08 (Willig) (Professor Willig was qualified as an expert in this case in "microeconomics, industrial organization, the use of statistics in economics, and the use of survey research and economics," and was previously qualified in other matters also as an expert in the economics of antitrust and intellectual property issues.). Finally, the Judges note that Professor Willig himself, in his role as an expert economic witness, explained that the differences in Pandora's marginal profits did not drive his Shapley Value Model results, because the opportunity costs of the record companies were so great as to dominate the royalty payout due to them pursuant to his modeling. *Id.* at 555 ("the opportunity costs almost exhaust[] the pre-royalty distributor profits [because][a]fter the distributor pays out to the labels their opportunity costs, there is not very much left ... to split among the parties.").

incurred by record companies in his Shapley Value Model.²⁶¹ More particularly, Professor Shapiro addresses Professor Willig's calculation of these opportunity costs through the latter's application of the "diversion rate"²⁶² estimations in the survey undertaken by Professor Gal Zauberman (Zauberman Survey) to estimate the extent to which listeners to noninteractive services reported they would divert their listening to alternative forms of music listening if noninteractive services were no longer available.

Professor Shapiro calculates a lower estimated opportunity cost than calculated by Professor Willig through the latter's application of the Zauberman Survey. Specifically, Professor Shapiro alleges that Professor Willig made errors that inflated the opportunity costs attributable to purchases of CDs, vinyl records (vinyl) and digital downloads that the survey data indicated would occur if noninteractive services were unavailable.

(A) Royalties per Purchaser of CDs, Vinyl & Digital Downloads

First, Professor Shapiro alleges that Professor Willig erroneously calculates the "CD/Vinyl/Digital Download Royalties per Purchaser" presented in Exhibit D.3 of the Willig WDT. Professor Willig first separately calculates these monthly per-purchaser

²⁶¹ To be clear, the opportunity cost issues addressed in this section of the Determination do not involve Professor Shapiro's broader economic argument regarding the asserted "Must Have" status of each Major, and the impact of that status on the calculation of opportunity costs.

²⁶² A "diversion rate" as used in the Zauberman Survey and as applied by Professor Willig is the percentage of surveyed listeners to a noninteractive service who would switch (divert) to another form of listening to music if the noninteractive service was not available. Professor Willig multiplies each percentage diversion rate by the royalty generated per-subscriber (or per-user, for the ad-supported service) by that other form of listening. The sum of those products equal Professor Willig's opportunity cost estimate. Willig WDT ¶ 47 & fig.6. As discussed *supra*, that opportunity cost estimate constitutes an economic cost that record companies must recover (*i.e.*, as a fallback value). The usefulness of the Zauberman Survey to calculate such switching, in the face of the Services' criticism, is separately discussed, elsewhere in this Determination.

royalties for each of the three product subcategories – CDs (\$[REDACTED] monthly per purchaser), Vinyl (\$[REDACTED] monthly per purchaser) and Digital Downloads (\$[REDACTED] monthly per purchaser). Willig WDT, app. D, ex. D.3 (Row “I” therein). The Zauberman Survey reported the diversion to all three of these purchases as a single diversion. But to calculate opportunity costs accurately, Professor Willig needs to unbundle the monthly per purchaser royalties for each of these three products *separately*. Accordingly, in order to generate his estimated opportunity cost calculation from the bundled categorization in the Zauberman Survey, Professor Willig attempts to calculate the “Weighted Average” of these three royalty figures. *Id.* (Row “I,” Column 4 therein). He calculates his opportunity cost total for this category – a monthly per purchase royalty of \$[REDACTED] – by weighting each of these three categories *by their share of retail revenue, inter se*. *Id.* (Row “G” & n.4 therein).

According to Professor Shapiro, *weighting by share of retail revenue is incorrect*. The correct weighting, he asserts, is by the *number of units purchased per buyer* of each of the three formats. Shapiro WRT, app. D at 81. To demonstrate that weighting by units purchased is the appropriate method, Professor Shapiro presents a step-by-step example:

1. Assume 10 individuals buy CDs and 10 individuals buy Digital Downloads
2. Assume each CD buyer spends an average of \$3 per month for CDs
3. Assume each Digital Download buyer spends \$9 per month for Digital Downloads
4. So, total retail revenues are \$30 per month for CDs (\$3 x 10 people)
5. And, total retail revenues are \$90 per month for Digital Downloads (\$9 x 10 people)
6. Assume net royalties paid are 50% of retail revenue for each unit of either product

7. So, CD monthly royalties equal \$15 (50% of \$30)
 8. And, Digital Download royalties equal \$45 (50% of \$90)
 9. Total royalties are therefore \$60 (\$15 + \$45)
 10. Because there are 20 assumed buyers (10 for each product) average monthly royalties per buyer = \$3 ($\$60 \div 20$)
 11. **But under Professor Willig's approach, the answer is NOT \$3.**
 12. Professor Willig instead weights the monthly royalties by the *share of retail revenue* attributable to each product, CDs or Digital Downloads.
 13. For CDs, this represents 25% of total retail revenue ($\$3 \times 10 \text{ people} = \$30 = 25\% \text{ of } \$120$)
 14. For Digital Downloads, this represents the remaining 75% of total retail revenue ($\$9 \times 10 \text{ people} = \$90 = 75\% \text{ of } \$120$)
 15. The 25% of total retail revenue attributable to CDs is one-third of the 75% of *total retail revenue* attributable to Digital Downloads
 16. So, weighting monthly royalty via retail revenue would be done via the following ratio:
- $$\begin{aligned}
 & \$30 \text{ CD revenue} \times (\$1.50 \text{ royalty per buyer}) + (\$90 \text{ Digital Download} \\
 & \text{revenue} \times \$4.50 \text{ royalty per buyer}) \div 30 + 90 = \\
 & (\$45 + \$405) \div (\$120) = \$450 \div \$120 = \mathbf{\$3.75}
 \end{aligned}$$
17. \$3.75 is 25% greater than \$3.00.

Shapiro WRT at 81-82.

Professor Willig acknowledges that Professor Shapiro's approach is the correct way to calculate opportunity costs for these physical royalties. 8/5/20 Tr. 504 (Willig) ("Professor Shapiro pointed out that maybe I wasn't perfectly logical in where I applied

my weights, and I think there was some merit to that point that Professor Shapiro made, so I went back and I changed that”).²⁶³

The Judges find Professor Shapiro’s re-calculation of these royalty weights – agreed to by Professor Willig – to be appropriate. The purpose of this opportunity cost analysis is to estimate *the number of units* of each subcategory of product (CDs, Vinyl and Digital Downloads) that would be purchased by each listener to a noninteractive service if that service was no longer available, and then multiply the number of units attributable to each subcategory by the royalty attributable to each item purchased. This exercise does not implicate retail prices. Accordingly, Professor Willig’s use of retail prices as weights introduces an irrelevant factor.

Applying the foregoing principles, the weighted average opportunity cost for these three products is \$[REDACTED], rather than the \$[REDACTED] in the Willig

²⁶³ Professor Willig attempted to add new testimony at the hearing regarding what he asserted was an unrelated but offsetting error made by Professor Shapiro in his calculations of these particular opportunity costs that, combined with Professor Willig’s admitted error, generated a higher opportunity cost of \$[REDACTED] for this category. However, Pandora’s counsel interposed a prompt objection, arguing that this proffered testimony would constitute “new analysis ... that’s out of bounds.” SoundExchange’s counsel did not respond when Pandora’s counsel asserted this objection, and, after a scheduled 15 minute mid-afternoon recess, SoundExchange’s counsel proceeded to question Professor Willig on other matters. The Judges then, *sua sponte*, afforded SoundExchange’s counsel an opportunity to respond to the objection by Pandora’s counsel that had prevented Professor Willig from testifying on this topic before the recess, so that the Judges could decide whether to sustain or overrule the objection raised by Pandora’s counsel. However, SoundExchange’s counsel declined to address the objection, claiming (incorrectly) that the testimony that was the subject of the objection “is already in the record.” 8/5/20 Tr. 504-05; 514-15 (colloquy). Thus, no such testimony regarding an alleged offset as to Professor Shapiro’s physical opportunity cost correction (accepted by Professor Willig) is in the record. (In SX PFFCL ¶¶ 635-636, SoundExchange attempts to rely on *counsel’s own analysis* of the record to substitute for the missing testimony by Professor Willig on this subject. That is plainly unacceptable.).

WDT, app. D, D.3 (Row “I,” column 4 therein). *See* Shapiro WRT, app. D at 82 (Figure D.1: Correction to Exhibit D.3 in the Willig WDT, Revised Exhibit D.3 (Row J therein).

**(B) Alleged Overestimation of Incremental Expenditures on
CDs/Vinyl/Digital Downloads**

Professor Shapiro’s next criticism with regard to Professor Willig’s opportunity cost analysis is that it “overestimates the incremental expenditures that listeners would make on CDs, Vinyl, and Digital Downloads if statutory webcasting were no longer available.” Shapiro WRT at 83. More specifically, Professor Shapiro asserts that Professor Willig makes two errors in this computation: First, he avers that Professor Willig allegedly *overestimates* the amount of money individuals would spend on CDs, Vinyl and Digital Downloads, an alleged error that causes Professor Willig to *inflate the opportunity cost input* into the Shapley Value Model. Second, according to Professor Shapiro, Professor Willig allegedly *underestimates* the number of individuals who would switch from a noninteractive service and to CDs, Vinyl and Digital Downloads, an alleged error *by which Professor Willig actually incorrectly reduces the opportunity cost input* in the Shapley Value Model. *Id.*

With regard to the allegation of overestimating the amount of spending on these three products, Professor Shapiro understands that Professor Willig assumes that people who switch some of their listening from noninteractive to CDs, Vinyl and Digital Downloads will then incrementally “spend as much as the average consumer who purchases those media types.” *Id.*²⁶⁴ As Professor Shapiro notes, this assumption carries with it the implicit assumption that these switching consumers *did not buy any of these*

²⁶⁴ As explained above, according to Professor Willig, the weighted average per consumer is \$[REDACTED] per month. However, as corrected by Professor Shapiro and credited by the Judges, the properly weighted average monthly spending for these products in the Scenario 2 analysis is \$[REDACTED] per month.

three products when they were listening to a noninteractive service, but then bought *the same amount of these music formats as an average user* subsequent to the hypothetical elimination of noninteractive services. *Id.* In fact, Professor Willig acknowledges that he treats these substitutions in the same all-or-nothing manner as the binary choice of whether to subscribe to an interactive streaming service if noninteractive services were unavailable. *See* Willig WDT, app. E, ¶ 13 (“I estimate incremental royalties from diversion to [CDs, Vinyl and Digital Downloads] in the same way as for [subscriptions to] Paid-[On Demand] and [Sirius XM].”).

Professor Shapiro opines that the proper approach is to treat the purchase of each of these three products in a manner analogous to the use of an ad-supported service, where the listener makes marginal listening decisions on a per performance basis. In support of his argument, Professor Shapiro enlists a useful supporter – *Professor Willig himself* – who, in *SDARS III*, converted royalties from incremental purchases of these three products on a per performance basis. Shapiro WRT at 83 n.205 (citing Professor Willig’s *SDARS III* Written Direct Testimony at B-5 to B-6). In further reliance on Professor Willig’s own analysis (in the present proceeding), Professor Shapiro points out that a document on which Professor Willig relied, Trial Ex. 5039, showed that on-demand listeners spend less per month on these three products than the average purchaser, generating only \$[REDACTED] in monthly royalties, substantially less than the \$[REDACTED] weighted average per month calculated by Professor Willig or the \$[REDACTED] recalculated weighted monthly average computed by Professor Shapiro. Professor Shapiro opines that it is unreasonable to conclude (as did Professor Willig), that noninteractive listeners – with their revealed lower Willingness-to-Pay for a streaming service – would spend multiple times more money than on demand listeners on CDs, Vinyl and Digital Downloads. Shapiro WRT at 83 n.206.

Professor Shapiro further relies on SoundExchange's own survey expert to support his critique of Professor Willig's estimation of opportunity cost emanating from the shift by some listeners to purchases of these three products. That survey expert, Professor Zauberman, reports that such diverted *ad-supported* listeners would allocate only 14.1% of their diverted time to these three products, and such diverted *subscribing* listeners would allocate even less of their diverted time, 9.9%, to these three products. Shapiro WRT at 84 n.207. According to Professor Shapiro, it is untenable for Professor Willig to assume that listeners and subscribers who divert such small fractions of their diverted time to these three products would also purchase these products in the same quantities (generating the same royalties) as all consumers who purchase these three products. Shapiro WRT at 84.

Instead, Professor Shapiro claims that it is more reasonable to assume that people who switch from noninteractive services to these three products "would generate incremental royalties consistent with the proportion of time they divert" *Id.* Once more, he enlists Professor Willig in support of his position, noting that, in *SDARS III*, Professor Willig's opportunity cost calculation applied the same assumption – estimating incremental royalties from CDs and downloads as proportional to incremental listening to these products. *Id.*

Professor Shapiro attempts to apply this "proportionate diversion" assumption by applying data from the "Share of the Ear" survey to his spending calculations. First, he incorporates in this analysis his calculation of the weighted average spending of consumers – \$[REDACTED] per month – on all three products. Second, Professor Shapiro calculates the incremental share of time that people would devote to these three products after switching from noninteractive services. Here, he relies on the "Share of the Ear" survey, which reports that Pandora subscribers allocate about [REDACTED]% of their music listening time to streaming music services, of which [REDACTED]% is

spent listening to Pandora. Thus, Pandora subscribers spend [REDACTED]% ([REDACTED]% x [REDACTED]%) of their music listening time on Pandora. And, as noted above, according to the Zauberman Survey, listeners to ad-supported noninteractive services will divert an average of 14.1% of their time to these three products, and noninteractive subscribers will divert an average of 9.9% of their time to these three products.

Putting these data points together, Professor Shapiro explains that “[t]he product of the share of time allocated to Pandora and the diversion rate to these three products [yields] the *incremental* time allocated to these [three products] in the absence of webcasting. *Id.* at 85. So, he calculates that users of the ad-supported service will allocate an incremental [REDACTED]% (*i.e.*, [REDACTED]% x [REDACTED]%) of their listening time to these three products and, in the same manner, subscribers will allocate [REDACTED]% (*i.e.*, [REDACTED]% x [REDACTED]%) of their listening time to these three products. *Id.*

The final step in Professor Shapiro’s analysis is his comparison of this incremental listening time to the average time listening to these three products. To take this step, Professor Shapiro applies additional data from the “Share of the Ear Survey.” That survey reports that the average music consumer spends [REDACTED]% of his or her listening hours listening to “Owned Music,” which is another way of referring to CDs, Vinyl and Digital Downloads. As Professor Shapiro notes, this implies that, for listeners switching away from the ad supported noninteractive services, incremental spending increases for these three products by approximately [REDACTED]% (*i.e.*, [REDACTED]%/[REDACTED]%), and, for listeners switching away from subscriptions

to noninteractive services, the increase is about [REDACTED]% (*i.e.*, [REDACTED]%/[REDACTED]%). Shapiro WRT app. D at 84-85.²⁶⁵

Professor Shapiro acknowledges that he is using data on switches in listening time (from noninteractive services to these three products) in order to estimate changes in the total monthly amount spent on those three products. *Id.* at 85. However, he considers increases in listening to be a reasonable proxy for increased purchases, rather than a confounding conflation of two data sets. *Id.* The Judges agree, and find his use of this change in listening to be a reasonable window into the likely changes in purchases. People who would increase their listening to music via these three products would need to purchase such products,²⁶⁶ and it would be highly irrational for people to purchase

²⁶⁵ Professor Shapiro acknowledges that the data in the “Share of Ear” survey is sufficient only to render his estimates informed approximations, because that survey [REDACTED]. However, Professor Shapiro believes this latter point makes his approximation more favorable to SoundExchange, because he posits that Pandora Premium subscribers listen to more songs than Pandora Plus subscribers (apparently because their willingness to pay a higher subscription price reveals their relatively greater preference to listen to songs). Thus, because the switching subscriber group in the survey includes such increased listening, their switching decisions would be greater than the switching behavior of Pandora Plus subscribers alone, *raising* the reported diversion ratio for these three products, raising the calculated opportunity cost and, accordingly, increasing the proposed royalty rate for subscription services derived by Professor Willig’s Shapley Value Model. *Id.* at 85 n.210. The Judges acknowledge these limitations in the Share of Ear survey, but they agree with Professor Shapiro that these issues are insufficient to reject his criticisms based on that survey’s data.

²⁶⁶ People who would choose instead to substitute (in whole or part) listening to their *already-owned* CDs, Vinyl and Digital Downloads would not necessarily purchase new quantities of these three products, but because that potential behavior is ignored in Professor Shapiro’s analysis here, the opportunity cost is skewed higher by his decision to ignore such consumer behavior in this context. (However, Professor Shapiro does attempt to adjust for the additional purchases by switchers who also switch by listening to their existing collections of these three products, as discussed below.)

these new products but not “consume” them, in order to substitute for their lost listening to noninteractive services.

Applying the foregoing changes, Professor Shapiro makes the following revisions to Professor Willig’s calculation of per person monthly incremental royalties for people who switched from noninteractive services to these three products:

For switching from ad-supported noninteractive services, Professor Shapiro calculates incremental royalties of \$[REDACTED] (*i.e.*, \$[REDACTED] x [REDACTED]% x ([REDACTED]%/[REDACTED]%), less than Professor Willig’s calculation of \$[REDACTED]; and

For switching from subscription noninteractive services, Professor Shapiro calculates incremental royalties of \$[REDACTED] (*i.e.*, \$[REDACTED] x [REDACTED]% x ([REDACTED]%/[REDACTED]%), less than Professor Willig’s calculation of \$[REDACTED].

Id. at 85-86.

The Judges find Professor Shapiro’s foregoing corrections to be reasonable and appropriate.

Professor Shapiro’s next opportunity cost adjustment, relating to these three products pertains to what he alleges is Professor Willig’s failure to address incremental purchases by “consumers who *already* listen to [owned] CDs, Vinyl, and Digital Downloads” *Id.* at 86. As noted *supra*, this correction is contrary to Pandora’s interest because it *increases* the opportunity cost associated with diversions to these three products, and, *ceteris paribus*, increases the royalties paid by Pandora under Professor Willig’s Shapley Value Model.

Professor Shapiro notes that the Zauberman Survey finds that 69% of listeners to an ad-supported noninteractive service and 67% of listeners to a subscription noninteractive service would divert *some* of their time to these three products in the

absence of such noninteractive services. However, Professor Willig does not estimate any opportunity cost associated with these listeners.²⁶⁷ This result suggests that these individuals would divert some time to buying and listening to new purchase of these three products, thereby creating an additional opportunity cost that would generate incremental royalties to the record companies under Professor Willig's Shapley Value Model. Shapiro WRT, app. D at 86.

According to Professor Shapiro, the correct opportunity cost associated with these purchases can be estimated as the product of: (1) these listener shares ([REDACTED]% for ad-supported listeners and [REDACTED]% for subscribers, multiplied by (2) the incremental monthly royalties per buyer of these three products, which Professor Shapiro (as discussed above) calculated as \$[REDACTED] for ad-supported switching and \$[REDACTED] for subscription switching.

Professor Shapiro therefore adjusts the opportunity cost associated with switching to these three products to \$[REDACTED] (*i.e.*, \$[REDACTED] x [REDACTED]%) for switching ad-supported users and to \$[REDACTED] (*i.e.*, \$[REDACTED] x [REDACTED]%) for switching subscribers. Shapiro WRT, app. D at 86; *see also id.* at Fig. 8.

The Judges find Professor Shapiro's adjustments in connection with the three products (CDs, Vinyl and Digital Downloads) to be reasonable and appropriate bases to increase the opportunity cost arising from diversions to these products.

²⁶⁷ Professor Willig classifies respondents in the Zauberman survey as "new" buyers of these three products *only* if they indicate both that they have not listened to CDs, Vinyl, and Digital Downloads in the previous 30 days *and* that they would listen to these media in case the webcaster went away. Under this definition, Professor Willig finds that [REDACTED]% of the listeners to the advertising-supported webcasters and [REDACTED]% of listeners to the subscription-based webcasters qualify as new buyers of CDs, Vinyl, and Digital Downloads. *See* Willig WDT, Fig.6.

(C) The Treatment of Non-Music and AM/FM Diversion in

Professor Willig's Opportunity Cost Analysis

Google's economic expert witness, Dr. Peterson, finds fault with Professor Willig's application of the results of the Zauberman Survey, by which he assumes that all the plays diverted from noninteractive services would be recaptured through listeners' accessing of royalty-bearing plays. Specifically, Dr. Peterson testifies as follows:

[Professor] Willig's model assumes that the entire ad-supported non-interactive statutory streaming business can be shut down, and the music industry won't lose a single performance. So that's inconsistent with how economists think of choice, and it's inconsistent with commonsense. If there are people whose favorite way to listen to music is through a Pandora-like service, we would certainly expect them to expand their listening hours as well and find opportunities to use that service when they would not listen to another service.

And ... the evidence for this is ... in the Zauberman surveys, where if you take the service away, some people say they will spend some of their day doing something other than listening to music. So it is incorrect to assume that all of the performances are preserved if you shut down the service.

8/25/20 Tr. 3734-35 (Peterson). This point ties in directly to the calculation of opportunity cost. As Dr. Peterson further notes, because the Zauberman Survey asks respondents how they would replace time spent listening to noninteractive services, those who would substitute non-royalty bearing activities would, necessarily, if noninteractive services were available, substitute away from the non-royalty bearing activities and listen to royalty-bearing noninteractive services. 8/25/20 Tr. 3735 (Peterson) ("[T]he consequence ... of course, is that if you join the [noninteractive] service, [the label] gain[s] ... performances and *the opportunity cost of the performances on the services is reduced as a result [and] this leads to an overstatement of opportunity costs.*") (emphasis added).

During cross-examination, Dr. Peterson made this point in greater detail in a manner that is well-worth quoting in full:

Q. And do you recall that one of the [Zauberman Survey] switching options was do something other than listen to music?

A. That is an option in the Zauberman Survey that I think is not properly reflected in Dr. Willig's model.

Q. Well, just looking at the survey, since the survey does contemplate people doing something other than listening to music, if a ... free non-interactive service was taken away, some people would go back to doing things other than listening to music, right?

A. That's correct.

Q. And doesn't that account for the idea that free non-interactive services could expand listening overall?

A. That free non-interactive services would expand listening overall?

Q. Right.

A. Oh, *that's exactly my point*. So ... Dr. Willig's model says if there are a million plays on the service, and the must-have labels shut it down, a million plays are diverted and a million plays are collected in the aggregate by the labels That's the assumption that's built into his model. And I'm asserting, I think *what you just said*, which is that *that's not a very good assumption because some people would say, well, I loved Pandora but since I can't have Pandora ... I'm going to read a book*. And so there would be fewer performances overall. And so *that aspect of Dr. Zauberman's survey is not at all reflected in the mathematics of Dr. Willig's model*. And that's – that's a problem.

Q. But looking at the survey, it does allow for the possibility that the – that the service could expand listening or not expand listening? *That option is there in the survey, right?*

A. But not in his model. I mean, it – and it actually doesn't really play into his opportunity cost either, which is very important here. So I disagree wholeheartedly with what you're saying.

8/25/20 Tr. 3799-3800 (Peterson) (emphasis added).

The Judges agree with Dr. Peterson. The Shapley Value Model constructed by Professor Willig overstates the opportunity costs because it does not consider the “opportunity benefits”²⁶⁸ generated by listeners to noninteractive services who would otherwise divert to a non-royalty bearing activity, such as reading a book, as Dr. Peterson

²⁶⁸ See *Ferraro and Taylor, supra*, at 7 (“An avoided benefit is a cost, and an avoided cost is a benefit.

Thus, the opportunity cost ... is ... the *net benefit forgone*.”) (emphasis added).

notes. But this defect in Professor Willig's opportunity cost calculation goes further, extending to any non-royalty bearing activity undertaken by a diverted listener, including listening to AM/FM (terrestrial radio).

As noted *supra*, AM/FM (terrestrial) radio stations do not pay royalties for their performances of sound recordings (because the Copyright Act does not confer a general public performance right on sound recording copyright owners). However, if noninteractive services attract listeners who would otherwise divert to terrestrial radio (as survey data in evidence indicate), there is a "negative opportunity cost" (*i.e.*, an "opportunity benefit") foregone by the record companies if they were to refuse to license noninteractive services. For example, at current statutory rates, the foregone "opportunity benefit" would be \$0.0018 per play listened to by terrestrial listeners who would have otherwise accessed music via an ad-supported noninteractive service if it existed, and \$0.0023 per play listened to by terrestrial listeners who would have otherwise accessed music via a subscription noninteractive service if it existed.

These "opportunity benefits" foregone are likely *not de minimis*, as the surveys in evidence in this proceeding indicate a significant amount of diversion to these alternatives by respondents who completed the survey. *See, e.g.*, Zauberman Survey ¶¶ 24-27 (85% of ad-supported noninteractive listeners would spend 27% of their diverted time listening to AM/FM radio over-the-air, and 79% of noninteractive subscribers would spend 18% of their diverted time listening to AM/FM radio in this royalty-free manner – if their form of noninteractive services were unavailable). *See also id.* (48% of ad-supported noninteractive listeners would spend 16% of their diverted time doing something other than listening to music and, for subscribers to noninteractive services, 50% would spend 10% of their diverted time in these non-royalty-bearing activities). As noted *supra*, the "opportunity benefit" of these lost listeners is \$0.0018 and \$0.0023 for

the plays diverted during such time periods from the ad-supported and subscriber noninteractive services, respectively.

SoundExchange notes though that Professor Willig engaged in a similar treatment of AM/FM listening, with his so-called “fork in the road approach,” that the Judges adopted in *SDARS III*, leaving interactive royalties unadjusted downward (thus not adjusting *downward* to correct for their complementary oligopoly power and not adjusting *upward* to reflect the absence of sound recording royalties for AM/FM plays). But, the NAB points out, although Professor Willig’s “fork in the road” testimony in *SDARS III* went unchallenged on cross-examination and in Sirius XM’s proposed findings, *see SDARS III*, 83 FR at 65238, the Services are challenging the point here. Thus, the NAB asserts that the appropriateness of that approach is properly at issue in this proceeding.

The Judges agree with the NAB in this regard. All rate proceedings are conducted *de novo*, and any factual determinations made in a prior proceeding therefore certainly can be considered anew now.

The Judges find that Professor Willig’s “fork in the road” approach does not adequately address the opportunity cost issue raised by Dr. Peterson. It is insufficient and off-point to treat lost listeners who divert to any non-royalty bearing alternatives as simply irrelevant to the complementary oligopoly premium attached to interactive opportunity costs. In fact, as Dr. Peterson makes clear, such non-royalty bearing alternatives – because they substitute for royalty-bearing noninteractive plays – generate what can be called “opportunity benefits.”

In addition to the “opportunity benefit” point addressed above, the NAB makes a separate *legal* criticism of Professor Willig’s “fork in the road” approach. Specifically, the NAB argues:

[T]o the extent including supracompetitive royalty inputs in an opportunity cost analysis yields supracompetitive outputs, those outputs are inconsistent

with the established *legal* standard requiring the rates set here to reflect effective competition. *Web IV*, [81 FR 26316] at 26332. Further, as a *legal* matter, there is a fundamental difference between complementary oligopoly rates for sound recording rights in interactive services and the lack of royalties for terrestrial radio play. The latter is a function of a Congressional judgment enshrined in federal copyright law. *See* 17 U.S.C. 106(6); *id.* sec. 114(a). The existence of complementary oligopoly power, in contrast, has never been blessed by Congress. To the contrary, this body has always regarded the majors' complementary oligopoly power as a feature of the market that must be corrected in establishing rates here. There is no sense in which it would be legally appropriate for the Judges to similarly "correct" lack of royalties resulting from the lack of a legally recognized public performance right for terrestrial radio play of sound recordings.

NAB PFFCL ¶ 136 n.34. In response, SoundExchange argues as follows:

For the first time at *any* point in this proceeding, NAB offers a lengthy argument against the "fork in the road" analysis offered by Professor Willig and endorsed by the Judges in *SDARS III*. *See* [83 FR 65210] at 65238. This is completely inappropriate argumentation that, despite being offered as a "finding of fact," is tellingly bereft of even a single supportive citation to the record in this case. *See* NAB PFFCL p.1 n.1. Notably, both Dr. Leonard and Professor Shapiro made explicit at trial that they were *not* challenging this concept.

SoundExchange's Corrected Replies to NAB's Proposed Findings of Fact and

Conclusions of Law ¶ 136 (footnote) (SX RPFFCL (to NAB)).

SoundExchange's reply is unavailing. The NAB's argument is not in the form of a proposed "finding of fact." Rather, it quite clearly is in the nature of a proposed

“conclusion of law.”²⁶⁹ Further, SoundExchange has not substantively replied to the NAB’s argument.²⁷⁰

Moreover, the Judges conclude that the legal substance of the NAB’s argument is persuasive. The absence of a public performance right for sound recordings on terrestrial radio – and hence the absence of any attached royalty obligation – was a statutory decision by Congress. The Judges identify no legal authority by which they may use that Congressional decision as an offset against the effect of complementary oligopoly power on the rate setting process. Moreover, because there is no royalty paid by terrestrial broadcasters for playing sound recordings, there is no basis for the Judges to simply *assume* either the existence or extent of a positive royalty, if such a public performance right actually existed. Indeed, regardless of the economic merits, the issue of whether such a public performance right and an associated royalty obligation should be created remains a matter of dispute in the legislative arena. *Compare* <https://www.soundexchange.com/advocacy/closing-the-amfm-radio-royalty-loophole/> (asserting that “the reality is that AM/FM radio – terrestrial broadcast radio – uses music

²⁶⁹ The NAB did not label ¶ 136 n.34 of its PFFCL as a conclusion of law. See NAB PFFCL at 1 n.1.

However, the parties’ *labeling* of separate portions of their post-hearing filings as proposed “findings of fact” or “conclusions of law” does not prevent the Judges from independently considering whether a particular proposal is either factual or legal, based upon the *substance* of the proposal. Indeed, because these submissions are merely *proposals*, neither the substance nor labeling of the submissions by the parties is binding on the Judges. Here, the NAB specifically argues that it would not be “*legally appropriate*” for the Judges to offset the complementary oligopoly effect based on the lack of a “*legally* recognized public performance right for terrestrial radio play of sound recordings.” NAB PFFCL ¶ 136 n.34 (emphasis added). Clearly, as a matter of substance, this assertion is a proposed legal conclusion.

²⁷⁰ SoundExchange neither responded substantively to this legal argument in its post-hearing Reply to the NAB, nor during closing arguments that followed the submission of the Proposed Findings of Fact and Conclusions of Law. See 11/19/20 Tr. 6062 *et seq.* (closing arguments).

to draw an audience that in turn allows broadcasters to bring in \$14.5 billion/year of revenue from advertising. While paying nothing for their primary product!”) *with* <https://www.nab.org/documents/newsroom/pressrelease.asp?id=4130> (asserting the allegedly “tremendous benefits of free, promotional airplay for musicians and labels.”).

Finally, the Services also make a further *factual* challenge regarding Professor Willig’s “fork in the road approach.” While not directly challenging that approach as a device for offsetting complementary oligopoly effects from the zero terrestrial royalty payments, Dr. Leonard, the NAB’s economic expert witness, asserts that this “fork in the road” approach does not address the complementary oligopoly impact of the “Must Have” nature of the Majors, which makes a noninteractive service’s “no license” negotiating strategy untenable. 8/24/20 Tr. 3411-13 (Leonard).

The Judges find Dr. Leonard’s point to be helpful. Elsewhere in this determination, the Judges make essentially the same point regarding the imbedding of a complementary oligopoly effect in the “arrival orderings” in Professor Willig’s Shapley Value Model. Dr. Leonard’s testimony in this regard is helpful because it makes clear that the “fork in the road” approach simply does not address this separate inclusion of a complementary oligopoly effect on the rates derived from Professor Willig’s Shapley Value Model.

v. The Adjusted Opportunity Costs in Professor Willig’s Shapley Value Model, Incorporating the Foregoing Changes in the Opportunity Cost Attributable to Music Purchases

Based on the foregoing adjustments accepted by the Judges, Professor Willig’s opportunity cost calculation must be adjusted, as set forth in the figure below:

Figure 8: Correcting Professor Willig’s Opportunity Cost Calculations [RESTRICTED]

[REDACTED]

Shapiro WRT at 50, Fig.8.

As the above table shows, Professor Shapiro's adjustments reduce the opportunity cost for ad-supported services from \$[REDACTED] (Professor Willig's estimate) to \$[REDACTED] (Professor Shapiro's adjusted estimate). For subscription services, these adjustments would reduce Professor Willig's opportunity cost estimate from \$[REDACTED] to Professor Shapiro's adjusted estimate of \$[REDACTED]. *Id.*; see also Willig WDT ¶ 47, Fig. 6.²⁷¹

However, according to Professor Shapiro, the "Share of Ear" analysis by Professor Willig erroneously inflates these opportunity costs, by overestimating the diversion rates to new subscriptions and new owned media purchases. Shapiro WRT, app. D at 86. Accordingly, Professor Shapiro rebuts this alternative approach by explaining the alleged limitations in Professor Willig's methodology and presenting an adjusted version that Professor Shapiro claims is a superior application of the "Share of Ear" data.

²⁷¹ In an attempt to find data consistent with his opportunity cost derived from the Zauberman Survey and other surveys in this proceeding, Professor Willig considered listening information generated by the Edison Research "Share of Ear" survey. Willig WDT ¶¶ 56-60 & app. F. However, on cross-examination, Professor Willig admitted that "it's *absolutely* my view that the [S]hare of the [E]ar study is not nearly as well founded for this purpose [I]n many ways it's really not really comparably informative for the issue at hand" 8/10/20 Tr. 1100 (Willig); see also Leonard WRT ¶¶ 23-29 (explaining that "royalty calculations based on the 'Share of Ear' survey are flawed" because, *inter alia*, they "ignore[] that some users already have subscriptions and already own CD/Vinyl/Digital Downloads [so that] [p]lays diverted to these options would not represent an opportunity cost to SoundExchange."). When both the proponent of survey evidence and the adversary decline to endorse its usefulness, the Judges will not consider that evidence as confirmation of other surveys, and the Judges place no weight on data generated by the Share of the Ear survey.

**vi. The Impact of All of Professor Shapiro’s Data Input and
Opportunity Cost Adjustments to Professor Willig’s Calculation
of Statutory Royalties in the Scenario 2 Approach**

Applying all of Professor Shapiro’s data and opportunity cost adjustments to Professor Willig’s Scenario 2 approach, the Judges find that the royalty rates proposed by Professor Willig must be significantly reduced. Specifically, these royalty rate differences are as follows:²⁷²

	Ad Supported	Subscription
Willig parameters	\$0.00297	\$0.00312
Shapiro Adjusted Inputs	[\$REDACTED]	[\$REDACTED]

See Willig WDT ¶ 51, Fig.9; Shapiro WRT, Fig.15 at 64.²⁷³

Additionally, because these adjusted rates are average rates over the 2021-2025 rate period, like Professor Willig’s proposed rates, they need to be discounted back to 2021 to establish rates for that first year of the rate period. Professor Willig deflated

²⁷² Professor Shapiro does not propose that the Judges utilize the foregoing royalty rates he calculates as the statutory royalty rates. *See* Shapiro WRT at 60.

²⁷³ As noted *supra*, note 247, Professor Willig also utilizes a N-I-N Model as a sensitivity check to his Shapley Value results. The Services assert, correctly, that the opportunity cost, profit margin and “Must Have” inputs Professor Willig utilizes in his N-I-N Model are identical to the inputs he utilizes in his Shapley Value Model. Services RPFCL ¶ 693 (incorporating by reference the Services’ critiques of Professor Willig’s Shapley Value Model). Similarly, the Judges’ consideration of the inputs in Professor Willig’s Shapley Value, *supra*, are equally applicable to his N-I-N Model, and reduce his proposed royalty rates to the same extent.

these rates by a factor of 0.96117, applying the U.S. Federal Open Market Committee’s inflation rate forecast for 2021 of two percent. Willig WDT ¶ 55 & n.43. (The Services have not objected to Professor Willig’s application of this inflation-adjustment process.). Applying Professor Willig’s adjustment factor of 0.96117, the Judges’ calculate 2021 royalty rates, based on their adoption of Professor Shapiro’s input-adjusted version of Professor Willig’s Shapley Value Model parameters, to be \$[REDACTED] for ad-supported services and \$[REDACTED] for subscription services.²⁷⁴

vii. The Impact of Shapley “Arrival Orderings” Given the Judges’

Finding That They do not Reflect “Effective Competition”

The Judges must incorporate their prior finding that Professor Willig’s Shapley Value Model incorporates complementary oligopoly power in the number of arrival orderings. There is no record evidence that suggests how Shapley Values and resulting royalties would be computed if the arrival orderings were changed to ameliorate the market power generated by the number of arrival orderings created by the fragmentation of copyright ownership of “Must Have” repertoires across three Majors.

The Judges note that Professor Willig’s Shapley Value Model does not explicitly address the potential impact of steering by a noninteractive service, *i.e.*, one that promises to play more sound recordings from a record company that agrees to a lower royalty or threatens to play fewer sound recordings from a record company that declines to agree to

²⁷⁴ For the ad-supported rate, $\$[REDACTED] \times [REDACTED] = \$[REDACTED]$ (rounded to $\$[REDACTED]$). For the subscription rate, $\$[REDACTED] \times [REDACTED] = \$[REDACTED]$ (rounded to $\$[REDACTED]$).

a lower royalty.²⁷⁵ *Accord* 8/18/20 Tr. 2638 (Shapiro) (“The primary focus of competition certainly ... in Professor Willig's model ... is not steering”).

Professor Willig maintains that his Shapley Value Model implicitly incorporates the value of steering because the characteristic function embodies “the extreme form of steering,” that is, “a black-out, non-license situation,” which, as explained *supra*, would result in the commercial demise of the noninteractive service because each Major is a “Must-Have.” 8/10/20 Tr. 1070-72 (Willig).

The Judges find Professor Willig’s treatment of a Major *blackout* to be a difference in kind rather than one of degree when compared with steering. An essential aspect of steering is that it serves to partially *disaggregate a record company’s repertoire* by allowing the noninteractive service to modify its song selection to marginally lower its royalty costs, while increasing the royalty revenue paid to the record company increasing plays via steering and decreasing royalty revenue to the record company “steered against” by the service. *See Web IV*, 81 FR at 26367. As also explained therein, the noninteractive service would not go out of business as it would if it lacked a license from a Major, but rather would see an improvement to its bottom line. *Id.* Clearly, therefore, marginal steering is different in kind. The characteristic function, on whose features Professor Willig relies, does not contemplate this steering-based disaggregation.²⁷⁶

²⁷⁵ As explained in *Web IV*, such promises and threats can result in the absence of actual steering, as all record companies agree to reduce their rates in order to avoid being “steered against.” *Web IV*, 81 Fed. Reg. at 26366.

²⁷⁶ The record does not reflect whether any Shapley Value Model even *could* address the impact of steering, but it is clear that Professor Willig’s modeling does not. As explained in *Web IV, supra*, the function of steering is a *redistribution* of value to adjust for complementary oligopoly power, whereas the characteristic function establishes the *maximum value of the coalition*.

Thus, because the royalty rates derived from Professor Willig’s Shapley Value Model reflect complementary oligopoly power (even as adjusted *supra*), they must be discounted to reflect effective competition. However, the Judges find nothing in the record to estimate the value of an effective competition adjustment to Professor Willig’s Shapley Model-derived royalty rates (as adjusted herein).²⁷⁷ Accordingly, the evidentiary record only allows the Judges to state with regard to the royalty rates they have determined—by adjusting Professor Willig’s Shapley Model-derived rates—that those 2021 rates, \$[REDACTED] for ad-supported services and \$[REDACTED] for subscription services, exceed an effectively competitive rate by an indeterminate amount. As such, these rates serve only as *limited guideposts*,²⁷⁸ indicating that *effectively competitive* rates generated via a Shapley Value Model would be less than these levels.²⁷⁹

²⁷⁷ More particularly, the Judges do not find that the effective competition adjustments applied to the benchmark and ratio-equivalency rates discussed elsewhere in this Determination, particularly those based on steering, can be logically applied to Professor Willig’s Shapley Value-derived rate. *See* 8/6/20 Tr. 777-79, 8/10/20 Tr. 1077-78 (Willig) (acknowledging he did not conduct an analysis based on steering because steering-based competition among the Majors would be inconsistent with the maximization of the “characteristic function,” *i.e.*, the maximization of the surplus the bargaining parties can obtain within his Shapley Value Model); *see also* 8/26/20 Tr. 3921 (Shapiro) (“none of our models have steering”).

²⁷⁸ When “the Judges are confronted with evidence that, standing alone, is not itself wholly sufficient, they may rely on that evidence “to *guide* the determination,” *i.e.*, by using it as a “*guide post*” when considering the application of more compelling evidence. *SDARS II*, 78 FR at 23063, 23066 (emphasis added).

²⁷⁹ As discussed *supra*, Professor Willig’s estimated rates are also too high because they do not reflect the “opportunity benefit” of listeners who would substitute noninteractive listening for non-royalty bearing activities, including listening to AM/FM radio. And, given the legal infirmity of the “fork in the road” approach, also discussed *supra*, his proposed rates are further improperly inflated.

2. Professor Shapiro's Nash-in-Nash Model

On behalf of Pandora, Professor Shapiro proffers two game theoretic bargaining theories to support proposed benchmark rates. In his direct testimony, he presents his “Nash-in-Nash” (N-I-N) model, and in his rebuttal testimony, as a critique of Professor Willig’s Shapley Value Model, Professor Shapiro advances his “Myerson Value” model.

Professor Shapiro explains that the licensing of performances of sound recordings needs to be analyzed with a “bargaining model [that] account[s] for the *multiple* bilateral negotiations that would take place” between noninteractive services and record companies. 8/18/20 Tr. 2654-55 (Shapiro). The dynamic in such a market, he explains, is that “although each record label would negotiate separately with each webcaster (assuming no coordination), the outcome of negotiations between one label-webcaster pair would be expected to affect the outcomes between other pairs.” *Id.*; Shapiro WDT at 27.²⁸⁰

The game theoretic approach that best addresses this simultaneous competition and bargaining context and is the “dominant way” of modeling such a market, according to Professor Shapiro, is the N-I-N model, a “non-cooperative” game theory model which utilizes “a consistent solution to simultaneous [bi-lateral] negotiations between multiple pairs of actors.” 8/18/20 Tr. 2655 (Shapiro).²⁸¹ Using his N-I-N model, Professor

²⁸⁰ In a two-player negotiation, the solution to the model is based on assumptions by each party regarding the negotiating strategy of the counterparty. In the N-I-N model, this concept is expanded to account for the expected outcomes in multiple two-player bargaining. Allan Collard-Wexler *et al.*, “Nash-in-Nash” *Bargaining: A Microfoundation for Applied Work*, 127 J. POL. ECON. 163, 165-166 (2019).

²⁸¹ For the difference between such a “non-cooperative” model and a “cooperative” model such as Professor Willig’s Shapley Value Model, *see supra* note 215. Professor Shapiro opines that a “non-cooperative” model better describes the bilateral negotiations hypothesized by the willing buyer / willing

Shapiro generates an ad-supported royalty rate of \$[REDACTED] per play, and \$[REDACTED] per play for subscription services. Shapiro WDT at 28 tbl.4, 32 tbl.7.

Professor Shapiro applies his N-I-N bargaining model for both ad-supported and subscription webcasting. For both forms of webcasting, his N-I-N model includes eight record companies with the largest shares of listening on Pandora²⁸² plus two “catch-all” categories of independent record companies. Shapiro WDT at 27-28 & tbl.4; *id.* at 75-76; 8/19/20 Tr. 2742, 2747 (Shapiro).

In Professor Shapiro’s N-I-N modeling “*the first step*” in identifying royalty rates “is to examine the opportunity cost to an individual record company of licensing its repertoire to a statutory webcaster.” Shapiro WDT at 4 (emphasis added). He defines record company opportunity costs in the same general manner as Professor Willig—the royalties foregone by a record company if it licenses its repertoire to a noninteractive service rather than to another type of service or offers its repertoire for sale as a physical or digital product.²⁸³ However, in performing his opportunity cost analysis, Professor

seller standard than the “cooperative” model invoked by Professor Willig, which is better suited for examining the behavior of “coalitions” of participants. *Id.* 2817-18 (Shapiro).

²⁸² The eight record companies are [REDACTED].

²⁸³ Professor Shapiro describes opportunity cost in the present context as follows:

The opportunity cost approach recognizes that, when a record company licenses its repertoire to a music service, some customers will devote additional listening time to that music service rather than listening to music in other ways. Because of the decreased listening to sound recordings through other media, the record company in question will lose some of the royalties it would otherwise have earned on performances or sales of recordings through these other media, to the extent the record company would have received incremental royalties from that listening.

Shapiro WDT at 3. In Professor Shapiro’s N-I-N model, a record company’s opportunity cost for licensing a webcaster is the product of four factors: (1) the total number of performances on the given webcaster’s service (referred to as “*N*” in his model); (2) the percentage of those performances that would be lost to other forms of listening in the absence of a license from the record company (referred to as “*L*” in his

Shapiro relies on a fundamental difference in the hypothetical unregulated noninteractive market. Specifically, he testifies:

[S]ome degree of competition among record companies would also arise if a webcasting service can obtain significant bargaining leverage by threatening to drop a given record company from its service entirely if the royalty rate offered by that record company is unreasonably high.

* * *

Importantly, my analysis here relies on new evidence that no individual record company is even close to being “must-have” for Pandora’s advertising-supported webcasting service.

Shapiro WDT at 11-12.

Accordingly, Professor Shapiro’s entire N-I-N Model relies upon “new evidence” that he asserts demonstrates that no single record company in fact is a “Must Have” for a noninteractive service. Because further application of his N-I-N Model turns on the sufficiency of this new evidence, the Judges to turn now to an examination of that evidence.

a. Pandora’ “Label Suppression Experiments”

To determine whether each of the Majors is a “Must Have” for noninteractive services, Professor Shapiro asked Pandora to conduct several “Label Suppression Experiments” (LSEs) pursuant to general instructions he provided to Pandora. Shapiro WDT app. E. The LSEs were conducted and supervised by an in-house Pandora economist employed as a “Distinguished Scientist,” Dr. David Reiley. Trial Ex. 4091 ¶¶ 1-4, 6, 11-13 (WDT of David Reiley) (Reiley WDT). Dr. Reiley constructed LSEs to answer the question: “What effect, if any, there would be on users’ listening if Pandora

model); (3) the average per-performance royalty the record company would earn from other forms of listening (referred to as “R”); and (4) the record company’s share of performances on the webcaster and the alternative services (referred to as “S”). Shapiro WDT at 17; 8/18/20 Tr. 2663-65 (Shapiro).

stopped playing the entire catalog of a particular record company on Pandora’s ad-supported service?” Reiley WDT ¶¶ 11, 13.

In an attempt to answer this question, Dr. Reiley and his colleagues ran five experimental treatments among listeners of Pandora’s ad-supported tier.²⁸⁴ One group in each experiment received the “treatment” (described below) and the other group in each experiment was the “control” group, which did not received the “treatment.”

Each treatment intentionally suppressed music from a different record company – not totally – but as completely as possible. Two of the treatments separately suppressed music from [REDACTED], and three separately suppressed music from [REDACTED]. *Id.* ¶ 12; 9/1/20 Tr. 4899 (Reiley).

Dr. Reiley then compared the listening behavior of users in the five treatment groups to the behavior of the control group, which did not receive any suppression treatment. Reiley WDT ¶ 19. He ran these LSEs over a roughly three-month period, from June 4 to August 31, 2019, and again for another approximately three-month period concluding December 4, 2019. Reiley WDT ¶ 16; Trial Ex. 4108 ¶¶ 4 (WRT of David Reiley) (Reiley WRT).

In analyzing the results, Dr. Reiley focused primarily on a particular metric: the average hours listened per registered Pandora ad-supported user, noting that “average hours per listener was a standard metric for in-house experiments at Pandora. Reiley WDT ¶ 19. According to Dr. Reiley, the LSEs demonstrated that “for the initial three-month experimental period, a near-total suppression of spins of any single record

²⁸⁴ To be included in either the LSE treatment or control groups, users must have listened to Pandora’s ad-supported radio product during the experimental period, and were not included if they did not satisfy that criterion. *See* 9/1/20 Tr. 4902-03 (Reiley).

company [REDACTED].” *Id.* ¶¶ 21-24; 9/1/20 Tr. 4906-07. (Reiley). He depicted the results of his three-month run of these LSEs in the following figure:

[RESTRICED]

[REDACTED]

Reiley WDT, Fig. 2.²⁸⁵

As noted *supra*, Dr. Reiley also extended these LSEs for an additional three months. He reported his cumulative six month totals, which, he testified, confirmed his conclusion regarding the three months of experiments, *viz.*, that [REDACTED]. Reiley WRT ¶¶ 12-16 & Fig.1.²⁸⁶

b. SoundExchange’s Criticism of Pandora’s LSEs, Pandora’s Responses, and the Judges’ Findings and Analysis

i. The LSEs are Unreliable and Uninformative

According to SoundExchange, the LSEs are not a reliable source of evidence, and thus cannot be utilized as an economic analysis to calculate Professor Shapiro’s input “*L*”

²⁸⁵ The figures are probabilistic, because they were derived from a *survey* of Pandora ad-supported listeners, rather than from the entire population of such listeners. Dr. Reiley testified that the LSE survey size was sufficient to produce, for the listening hour reported effects, 95% confidence intervals that would be no wider than +/-5% for [REDACTED], and no wider than +/-0.5% for [REDACTED]. Reiley WDT ¶ 18. Accordingly, in the results displayed in Figure 2 in the accompanying text, the point estimates are shown by the dots, and horizontal lines indicating the width of the 95% confidence intervals.

²⁸⁶ In a pre-hearing Motion, the Judges disallowed Pandora from using the cumulative results of the six month survey, because Dr. Reiley’s testimony regarding the final three months of the survey should have been included in his direct testimony, or in timely filed amended direct testimony, rather than in his written *rebuttal* testimony. However, the Judges admitted Dr. Reiley’s rebuttal testimony for the narrower purpose of attempting to rebut SoundExchange’s position that the Judges should deem all three Majors to be “Must Haves” for noninteractive services. To be clear, the Judges do not consider the cumulative (six months) data for any *affirmative* purpose.

in the opportunity cost calculation necessary for his N-I-N- modeling. Willig WRT ¶¶ 22-27; 8/5/20 Tr. 351-53, 570-72, 574 (Willig). Even at this high conclusory level, Pandora offers less than a full-throated defense of the LSEs, asserting not that the LSEs are objectively sufficient and persuasive evidence, but that, comparatively, they are “the best, most reliable evidence of the effects of a record label blackout on listening on Pandora’s ad-supported radio tier.” Services RPFCL ¶ 852 (citing 9/1/20 Tr. 4927-28 (Reiley)).

The first criticism levelled by SoundExchange is that the design of the LSEs impeded detection by respondents who were exposed to a label blackout (the treatment group) of the existence of the blackout. More particularly, a SoundExchange economic expert witness, Professor Catherine Tucker, criticized the LSEs for making the LSEs’ participants, “blind” to the experiments’ nature (*see* Reiley WDT ¶ 7), in that they were not made aware that they had lost access to the repertoire of the suppressed record company. Trial Ex. 5605 ¶ 18 (CWRT of Catherine Tucker) (Tucker WRT); 8/17/20 Tr. 2280-81 (Tucker).

Pandora responds by pointing to Dr. Reiley’s testimony, in which he invokes the principal scientific reason for making the study “blind” to participants. Specifically, he identifies what is known in experimental work as the “Hawthorne effect,” by which participants in an experiment modify their behavior simply because they become aware of the experiment. 9/1/20 Tr. 4927-28 (Reiley). Moreover, Pandora argues that it would have no reason to notify ad-supported users of the existence of a *real-world* label blackout, and that any communication Pandora could have attempted to convey to the “treatment groups” would not even “come close to replicating the sort of real-world *third-party* communications” disclosing the blackout (discussed below) that Professor Tucker claims (wrongly in Pandora’s opinion) would occur. Services RPFCL ¶ 858.

The Judges find significant merit in SoundExchange’s criticism. The failure of the LSEs to provide notice to participants in the “treatment groups” that they had lost access to the repertoire of a given record company is an important omission. Its importance is based on the fact that the value of a webcasting service lies not only in the sound recordings a listener hears, but the listeners’ understanding of the repertoire to which the service has access and derivatively, which the listener can expect to be included in the sound recordings he or she may hear. To be sure, such access likely has more value to an interactive (on demand) service than to a noninteractive service, but that comparison is hardly dispositive. And the assertion by Pandora that *it* could hardly have provided the same type of notice and disclosure that third parties would have disseminated (discussed in more detail below), while likely correct, only underscores the incompleteness and lack of necessary “real world” elements in the experiments. That is, the fact that the necessary disclosures of information could not possibly have been included in the experiment – *by Pandora’s own admission* – indicates to the Judges that the error lies in the fundamentals of the LSEs, and that Pandora’s unavoidable omission of such notices is hardly an argument supportive of the use of the LSEs in this proceeding.²⁸⁷

²⁸⁷ The absence of disclosure to the treatment group of the loss of access to the repertoire of a record company is inconsistent with if not antithetical to, the idea of modeling the hypothetical market in a manner consistent with “effective competition.” As Professor Shapiro concedes, if a Major is blacked-out on Pandora, listeners have lost what economists describe as “access value.” 8/19/20 Tr. 2709 (Shapiro). But without disclosure of that lost value, the diminished access is not known to listeners (unless they learn of the lost access from some other source, as posited by SoundExchange). This informational deficiency is important. One of the necessary conditions for a market to be effective is the absence of asymmetric information. *See* CLIFFORD WINSTON, GOVERNMENT FAILURE VERSUS MARKET FAILURE at 27 (2006) (“efficiency ... requires that buyers and sellers be fully informed If consumers are uninformed or

The Judges also reject Dr. Reiley’s reliance on the general principle that participants in an experiment should not be made aware of the nature of the experiment. Rather, the Judges concur with Professor Tucker, who testifies that this principle is inapplicable where, as here, “we’re interested in actually measuring what happens when people receive and know about receiving a degraded service.” 8/17/20 Tr. 2281 (Tucker).

Several SoundExchange witnesses testify that services in competition with Pandora (if it was the service blacking-out a label) would have strong economic incentives to disseminate and exploit this information by: (1) publicizing Pandora’s

misinformed about the quality of a product, they may derive less utility from it than they expected.”); Karl-Gustaf Lofgren et al., *Markets with Asymmetric Information: The Contributions of George Akerlof, Michael Spence and Joseph Stiglitz*, 104 SCANDINAVIAN J. ECON., no. 2, 195, 205 (2002) (Joseph Stiglitz, winner of the Nobel Prize for his work on the economics of information, and “probably the most cited researcher within the information economics literature ... has time and again pointed out that economic models may be quite misleading if they disregard informational asymmetries [and] that many markets take on a different guise in the perspective of asymmetric information”); DIANE COYLE, MARKETS, STATE, AND PEOPLE 73, 303 (2020) (“The absence or presence of information asymmetries can make all the difference to how a market functions The assessment of efficiency ... should account for ... likely behavioral responses.”). But the LSEs tacitly assume a market infected by such informational asymmetry regarding the offerings of a noninteractive service, and in so doing create an experimental market infused not with effective competition, but rather with *market failure*. See JOSEPH E. STIGLITZ & JAY K. ROSENGARD, ECONOMICS OF THE PUBLIC SECTOR 93 (4th ed. 2015) (identifying “imperfect information” as one of “six basic market failures”); ANNE STEINEMAN, MICROECONOMICS FOR PUBLIC DECISIONS 147 (3d ed. 2018) (“Market failures can also occur because of imperfect information. Efficiency requires *that all relevant information be available to consumers*”) (emphasis added). The irony of this point is not lost on the Judges: Professor Shapiro endorses as evidence of a hypothetical effectively competitive market an experiment (the LSEs) that generate the absence of a condition—adequate information – whose presence is necessary to avoid market failure.

shrunk repertoire; (2) emphasizing their own more complete repertoires; (3) targeting existing Pandora users via advertising campaigns; (4) offering promotional prices in conjunction with an emphasis on the new gap in repertoires, to encourage switching away from Pandora; and (5) expanding their own offerings or changing their prices in response to the change offering environment. Tucker WRT ¶¶ 48-49; Willig WRT ¶¶ 23-24; Zauberman WRT ¶¶ 23-25, 30-32; Simonson WRT ¶¶ 21-27, 30; 8/5/20 Tr. 570-74 (Willig). Moreover, SoundExchange notes that even Professor Shapiro concedes that Pandora's competitors would engage in such messaging if Pandora blacked-out a Major. 8/19/20 Tr. 2704-06 (Shapiro). Further, Professor Shapiro also concedes that "there would very likely be external sources of information about this that users would receive." In an attempt to address this likely reality, he simply used the high statistical point estimate [REDACTED] as a proxy for the lost listening, even though he [REDACTED]" 8/19/20 Tr. 2703 (Shapiro) (emphasis added). In fact, Professor Shapiro broadly acknowledges it is "true" that "the experiments [are] imperfect in various respects" *Id.* at 2710.

Despite its expert making these concessions regarding its own experiments, Pandora criticizes *SoundExchange* for not offering evidence beyond its witnesses' testimony regarding the likely industry responses to a Major's blackout. The Judges find this criticism is meritless and only underscores the inherent deficiencies in the LSEs. Pandora's argument is essentially that, although its model does not specify necessary elements of reality, the adverse party, SoundExchange, bore the burden of producing evidence of how that reality would affect noninteractive services in the real world.

Quite the contrary, Pandora, as the proponent of the LSE evidence, bears the burden of producing sufficient evidence to demonstrate the necessary realism of its

experimental modeling.²⁸⁸ Economic experiments are models,²⁸⁹ and all economic models need to be analyzed through a “realism filter.” DANI RODRIK, ECONOMICS RULES at 27 (2015) (noting that the “critical assumptions” of an economic model must be evaluated through a “realism filter” to determine whether more realistic assumptions “would produce a substantive difference in the conclusion produced by the model”). Pandora’s LSEs do not pass through such a “realism filter.”

SoundExchange further asserts that the disclosure of the black-out would not be made only by Pandora’s competitors. It notes that, in the real-world, beyond the confines of the experimental world, consumers would learn about a Major’s blackout on a noninteractive service from a number of additional sources, specifically, by artists and managers whose sound recordings and musical works would be unavailable and by the record company that had been subject to the blackout. SoundExchange asserts that these persons and entities would have the economic incentive to disseminate information regarding the blackout, and how their sound recordings could otherwise be accessed. 8/5/20 Tr. 352-53, 570-71 (Willig); 8/17/20 Tr. 2285 (Tucker). Other witness testimony explained that additional information channels – social media platforms, news media and

²⁸⁸ Pandora also casts doubt on whether any “third party has any reliable method for reaching the vast majority of Pandora users.” Services RPFCL ¶ 860. Although this, too, is speculation, it is noteworthy in that Pandora is specifically making the general asymmetric information point the Judges made *supra*—arguing in essence that it has superior information that prevents third parties from providing customers of information regarding the service they are accessing. This argument hardly supports a finding that the LSEs reflect a real world market that would be *effectively competitive*.

²⁸⁹ See Uskali Mäki, *Models are Experiments, Experiments are Models*, 12 J. ECON. METHODOLOGY 303, 306 (2005) (“experimental systems ... are artificially designed and constructed substitute systems, controlled mini-worlds that are directly examined in order to indirectly generate information about the ... world outside the laboratory – such as economic systems and behavior [S]uch experimental systems are ... material models of aspects of the rest of the world.”) (emphasis added).

personal networks of friends and family – would also be able to inform listeners to a noninteractive service that the repertoire of songs to which they have access had been reduced. Tucker WRT ¶¶ 19-27; Willig WRT ¶ 24; Zauberman WRT ¶¶ 25-33; Simonson WRT ¶¶ 21-30.

In response, Pandora again chastises SoundExchange for offering only speculation regarding the anticipated response by noninteractive listeners upon learning of the blacking out of a Major record company from economically motivated industry competitors and stakeholders. Pandora further criticizes SoundExchange's witnesses for relying on anecdotes pertaining to the reactions of listeners to on demand services upon learning that they had lost access to identifiable music from a particular Major. As noted above, the Judges agree with Pandora that the reactions by noninteractive listeners could be less intense, given that they have no expectation of hearing a particular song. But again, the market for noninteractive music also involves the promotion of access to a large repertoire of music that can be accessed by the curators (algorithmic or human) of that repository. A shrinking of that repertoire clearly would constitute important relevant information for a listener in choosing to remain with, or begin listening to, a noninteractive service. And once again, the burden of producing evidence regarding the importance, *vel non*, of such information is properly borne by Pandora, as the proponent of the experimental evidence, so that its model is sufficiently realistic and useful when proffered to set statutory rates with real world impact. Finally, as noted *supra* regarding the response by Pandora's competitors, Pandora's assertion that its experiment could not model third-party dissemination of true information and listener reaction thereto is actually a self-criticism by Pandora of the usefulness of its experiment, rather than an appropriate critique of the SoundExchange witnesses whose testimony revealed the insufficiency of the experiment's design. That is, if the LSEs could not possibly have been designed to demonstrate real-world effects, that evidence is lacking in probative

value, and Pandora cannot escape that finding by attempting to lay off on its adversary a burden of producing contrary evidence.²⁹⁰

Another defect in the LSEs alleged by SoundExchange is that Pandora did not prevent listeners in the treatment group from listening to songs via Pandora's "Premium Access" feature, which allows ad-supported users to access on-demand functionality for a limited time in exchange for viewing additional video advertisements. Reiley WDT ¶ 15; Phillips WDT ¶¶ 25-26. Pandora entices ad-supported users with repeated prompts and an offer to access bespoke songs if an ad-supported user "opt[s] into a Premium Access Session." 8/31/30 Tr. 4645-46, 4632-33 (Phillips).

According to SoundExchange, Pandora's decision not to suppress content when listeners in a treatment group were using "Premium Access" had the effect of masking the label blackouts, logically leading listeners in the treatment groups to believe that the repertoire of the blacked-out label was still available to them. Reiley WDT ¶ 15; Phillips WDT ¶¶ 25-26; Tucker WRT ¶ 38; 8/17/20 Tr. 2319-20 (Tucker); 8/31/30 Tr. 4645-46 (Phillips). Moreover, SoundExchange maintains that this disguise effect existed regardless of whether ad-supported listeners ultimately opted into Premium Access sessions, because the offer suggested the accessibility of all repertoires, including those of the blacked-out record company. Tucker WRT ¶¶ 37-38.

Pandora acknowledges that the non-suppression of the blacked-out record company's repertoire on "Premium Access" was not an error or oversight, but rather intentional. Services RPFCL ¶¶ 870, 872. It also concedes that listeners in the treatment groups heard a "small number" of tracks from the otherwise blacked-out record

²⁹⁰ Pandora also emphasizes that [REDACTED]. However, the record reflects no basis for the Judges to apply the circumstances surrounding the launching of a new form of music distribution to the overall noninteractive market. Similarly, the Judges give little weight to SoundExchange's reliance on the specific example of [REDACTED]. See SX PFFCL ¶ 862; Services RPFCL ¶ 862.

company. SX PFFCL ¶ 874. Pandora further asserts that SoundExchange has proffered no evidence that such Premium Access was intended to, or in fact did, “disguise” the absence of a blacked-out repertoire, because such limited access would not be confused with access on Pandora’s noninteractive service. Services RPFCL ¶ 873. In sum, Pandora, while acknowledging that the LSEs therefore did not generate “perfect suppression,” notes that [REDACTED]% of the blacked-out record companies’ recordings were in fact suppressed. Services RPFCL ¶ 875 (and citations therein).

The Judges find SoundExchange’s criticism of the LSEs in this regard well-taken. If listeners heard otherwise blacked-out songs after accessing Pandora’s ad-supported service, there is no persuasive evidence that they would recall, going forward, whether that the songs or artists they heard – which included recordings that they selected – had been accessed via the noninteractive curation process or via the Premium Access feature on that otherwise noninteractive service. Rather, Pandora asks the Judges simply to assume that listeners would be so attentive as to parse and recall the specific Pandora services through which they heard certain recordings. There is simply no reason to make such a counterintuitive assumption. Further, because a noninteractive service offers a listener the potential to hear music from a large repertoire, when a listener hears a sound recording from a particular favored artist, the listener has no reason to conclude that such recordings are in fact unavailable via the noninteractive service. That is, it seems at least equally reasonable to assume that a listener would expect to be able to access songs it hears on a service, regardless of the precise tier on which the service provided the song to the listener – at least without some further sufficient evidence to the contrary. Once again, Pandora bears the burden of producing sufficient evidence in this regard, and no such evidence is in the record.

Additionally, Pandora’s own experience in conducting experiments should have put it on notice that the periodic playing of songs that are otherwise suppressed is

sufficient to disguise the suppression. In its steering experiments relied upon by the Judges in *Web IV*, Pandora explained that by decreasing the frequency of the plays of songs from high-royalty record companies, *without completely eliminating plays of those songs*, Pandora could reduce its royalty costs without degrading the listener's perception of the repertoire of the service. Here too, the playing of otherwise blacked-out record company songs accessed via the noninteractive service, in the Premium Access promotional space, potentially allowed the listener to assume no such degradation. And importantly, Pandora does not provide any reason why it did not turn off the Premium Access feature for listeners selected for the LSEs, which would have mooted this concern.²⁹¹

SoundExchange notes that in light of the foregoing deficiencies in the LSEs, even Dr. Reiley and Professor Shapiro make a consequential admission: They simply do not know how ad-supported listeners would have reacted if they were made aware of the label blackouts. *See* 9/1/20 Tr. 4928 (Reiley) (“[I]f we imagine that listeners were informed of [the missing content], then I don’t know what impact that would have on listening.”); Shapiro WDT at 21 (“LSEs “do not fully capture what would happen in the real world in the event of a blackout resulting from one of [the] record companies withholding its repertoire from Pandora [L]isteners were presumably not aware of the blackout, and they might react more strongly if they were aware.”).

²⁹¹ Turning off the Premium Access feature apparently would have represented a degrading of the ad-supported service that listeners might notice, interfered with Pandora’s attempt to market its premium product to these ad-supported listeners and perhaps even violated its agreements with its licensors (Pandora does not say). But Pandora’s desire to maintain the Premium Access feature for the treatment groups underscores its inability (or unwillingness) to construct a sufficiently probative experiment given the nature of the ad-supported service.

SoundExchange further notes that, although Pandora’s goal was to achieve 100% label suppression in the treatment group (aside from allowing Premium Access to plays of suppressed labels), it failed even in that endeavor, for several reasons. First, SoundExchange identifies what it describes as a “technical error,” whereby the suppression was turned off for a period of time over several days—June 13-16 and 26—during the treatment period because of various software and system upgrades. Reiley WDT ¶ 31; Reiley 9/1/20 Tr. 4956-58 (Reiley). For Pandora’s 89-day experiment, this five-day period represents approximately 6% of the entire experimental period during which the suppression was partially interrupted. The Judges find that this technical error in the experiment, standing alone, would not invalidate the LSEs, but in combination with the other defects, serves to eliminate further any weight the Judges could place on the LSEs.

Next, SoundExchange points out that Pandora continued to provide a number of “miscellaneous provider tracks”²⁹² to the treatment group, including recordings from the suppressed labels, again causing the suppression level to be reduced. Reiley WDT ¶ 28; Reiley WRT ¶¶ 21-23; 8/17/20 Tr. 2321-2322 (Tucker). More particularly, Professor Tucker testified that approximately [REDACTED]% of users in the major label treatment groups were exposed to at least one “miscellaneous provider” track during the LSEs. *See* Tucker WRT app. 1 (Rows 13-14); 8/17/20 Tr. 2322 (Tucker).

[REDACTED] Dr. Reiley’s understanding that few spins of these “miscellaneous provider tracks” constituted plays from the suppressed labels. Reiley WDT ¶ 30; Reiley WRT ¶ 23 (noting that his team tested a sample of miscellaneous provider tracks and

²⁹² “Miscellaneous provider tracks” are recordings that have not yet been identified as covered by Pandora’s current direct license agreements but are nonetheless played by Pandora “because of the long history of user data associated with those tracks” (*i.e.*, they are popular tracks). Reiley WDT ¶ 28.

determined that only 10-15% of them (*i.e.*, 10-15% of 6% of total plays) were from the suppressed label); 9/1/20 Tr. 4921-24 (Reiley) (“Most of [the miscellaneous provider tracks] are going to be tracks that belong to other owners, since [REDACTED]).

With regard to Professor Tucker’s testimony, Pandora notes that she conceded that the fact that approximately [REDACTED]% of users heard a miscellaneous provider track during the experimental period does not mean that they heard a *suppressed label track*. See 8/18/20 Tr. 2403 (Tucker). Also, Pandora points out that the [REDACTED]% figure reported here by SoundExchange ([REDACTED]% to be precise) includes miscellaneous provider tracks played *during Premium Access sessions*. See Tucker WRT app. 1 at lines 13-14. As explained *supra*, Premium Access sessions had been intentionally excluded from the LSEs.

With regard to the number of potential miscellaneous provider tracks to which a listener in the treatment group may have been exposed, the Judges agree that it is likely that such exposure was relatively low. However, even this likely small effect, when combined with the other deficiencies in the LSEs, renders the experimental results less than conclusive. Moreover, the fact that many of these miscellaneous provider tracks may have been provided within the Premium Access feature does not mitigate the imperfection. As stated *supra*, Pandora has not offered a sufficient explanation as to why ad-supported listeners would accurately parse the difference between songs played as ad-supported or as Premium Access songs accessed via the ad-supported service, in order to be cognizant of the loss of certain songs on the ad-supported tier alone. Further, because these “miscellaneous provider tracks” are apparently relatively popular,²⁹³ they may have an outsized influence on a listener’s satisfaction with the ad-supported service compared

²⁹³ See *supra* note 292.

to less popular songs, and thus a relatively greater impact on the accuracy of the experiment.

Another issue raised by SoundExchange is the LSEs' handling of ad-supported users who upgraded to Pandora Plus or Pandora Premium subscription tiers during the experiment and thus did not receive the suppression treatment during the entire experimental period. Despite these upgradings, Pandora continued to analyze these upgraded listeners as part of the treatment group. *See* Reiley WDT ¶ 32 (“[A]lthough listeners who upgraded to Plus or Premium no longer received treatment after subscribing, I have not excluded those listeners or their listening metrics from the analysis”); *see also* Reiley WRT ¶ 19. More particularly, the experimental data showed that [REDACTED]% of ad-supported users in the [REDACTED] treatment group and [REDACTED]% in the [REDACTED] treatment group upgraded to a subscription tier during the LSEs. Tucker WRT app. 1; Reiley WDT ¶ 32. Professor Tucker explained that this upgrading has the potential of masking the shift by ad-supported users in the ad-supported service. 8/17/20 Tr. 2318 (Tucker).

Pandora does not dispute the accuracy of the data as presented by Professor Tucker. Rather, Dr. Reiley states that he did not exclude these listeners in part “because they did receive at least partial treatment *prior* to the upgrade” Reiley WRT ¶ 19. Although that is not inherently unreasonable, there is also merit in Professor Tucker’s assertion. The upgrading individuals may have abandoned the ad-supported service (via their upgrading) *because* of the label suppression, which would have justified either the

elimination of those upgraders from the experiment, or perhaps counting them as having abandoned the ad-supported service *because* of the suppression.²⁹⁴

Next, SoundExchange avers that the LSEs cannot estimate how consumers would react over a time period longer than the LSEs, such as the five-year rate-setting period. *See* Tucker WRT ¶ 77 (“Consumer learning can lead to substantial difference in the measured effect of a treatment over time”); 8/17/20 Tr. 2323-25 (Tucker) (“[C]ertainly the substance of these critiques does not change when you look at a longer time period.”).

In response, Pandora relies on the testimony of Professor Shapiro and Dr. Reiley, in which they extrapolate to the LSEs longer-term effects *from other experiments* that had measured the longer-term impact of ad-loads on listening and the impact of steering, respectively. Reiley WDT ¶ 36; Reiley WRT ¶ 27. More particularly, Dr. Reiley and Professor Shapiro found that, by this extrapolation, the three-month LSEs should be adjusted by a factor of three, increasing the negative impact associated with a label blackout (and finding that the adjustment factor should equal two for the six-months of data). Shapiro WDT at 21, 24-25, tbl.3; 8/19/20 Tr. 2701 (Shapiro).

SoundExchange challenges as *ad hoc* Pandora’s reliance on these unrelated experiments. It argues that neither Dr. Reiley nor Professor Shapiro provides “legitimate support for why this relationship, which was obtained from a different experiment involving a different treatment and a different experimental design, is applicable here.” Tucker WRT ¶ 93; 8/5/20 Tr. 583-84 (Willig). Going more deeply, Professor Willig opined that “there is really no particular reason to believe, from a logical basis or an economic basis, that the three times or the two times is an accurate correction.” 8/5/20

²⁹⁴ Professor Reiley responded to this criticism, but his testimony in that regard is unclear. However, he did report on the minimal level of exposure these participants received of the suppressed labels after they had upgraded. Reiley WRT ¶ 19.

Tr. 583 (Willig). Multiple SoundExchange witnesses further explained that these other two experiments are simply too unlike the LSEs to provide useful information. Tucker WRT ¶¶ 76-83; Zauberman WRT ¶¶ 40-45, 53-56; Simonson WRT ¶¶ 41-45; Willig WRT ¶ 26.

Going even further, Professor Willig distinguished the ad-load experiment from the LSEs:

[A]d load is a different sort of a degradation of the service from the point of view of the listeners than a narrowing of the repertoire of the music that's played, and the ability of a listener to discern that the ad load has increased is going to be relatively obvious. And whether or not that's the case for the missing music is somewhat less certain And so the applicability of the information from the ad loads study to the LSEs is really questionable. It is really rather speculative.

8/5/20 Tr. 584 (Willig). Finally, with regard to the ad load experiment comparison, SoundExchange notes that Dr. Reiley acknowledged the absence of any record evidence to support what is essentially nothing more than his assumption of a correlation between the effects of ad load and label suppression. 9/1/20 Tr. 4970 (Reiley).

Regarding the other purportedly comparative experiment – the steering experiments conducted by Pandora's Dr. Stephan McBride – SoundExchange's witnesses identified an important dissimilarity with the LSEs: the McBride steering experiments measured the effects of steering only up to a 30% level. *See* 9/1/20 Tr. 4925, 4990 (Reiley). Nonetheless, Dr. Reiley simply assumed that he could extrapolate from the results of a steering experiment in order to generate long-term effects from a [REDACTED]% suppression of a label. *Id.* at 4925 (Reiley).

Finally, SoundExchange again relies on the testimony of Professor Reiley himself to demonstrate the arbitrariness of his decision to multiply the three-month results by three, and the six-month results by two. Specifically, Dr. Reiley acknowledged that "it's impossible to know exactly what would happen without running the experiment for a ... much longer period of time," and that his comparison to the ad-load experiment was a

“best guess at what we think the long-run effects are likely to be.” 9/1/20 Tr. 4910-11 (Reiley).

In rebuttal to these criticisms, Pandora relies first on Dr. Reiley’s testimony that he had the benefit of having been involved in Pandora’s ad-load experiments, but he acknowledged that Pandora had engaged in few other long-term experiments. Reiley WDT ¶¶ 27-28; 9/1/20 Tr. 4915-16 (Reiley). Based on that experience, he observed a decline in listening hours over approximately the first year of the ad-load experiments that was linear in nature, which he testified *could* render reasonable and justifiable Professor Shapiro’s decision to double the effects of the six-month LSE experiment. Reiley WDT ¶ 28; 8/19/20 Tr. 2701 (Shapiro).

Pandora nonetheless concedes that its ad-load experiment was not perfectly correlated with the LSEs with regard to long-term effects. Attempting to turn the tables on SoundExchange, Pandora and Dr. Reiley chastise SoundExchange (yet again) for not presenting any contrary evidence. 9/1/20 Tr. 4907-09 (Reiley).

In similar fashion, Pandora relies on Dr. Reiley’s conclusion that the LSEs were also consistent with longer-run extrapolations of Dr. McBride’s steering experiments. However, Dr. Reiley acknowledges the wider confidence intervals in the LSEs’ results compared to the steering experiments. 9/1/20 Tr. 4925, 4990 (Reiley). And, as with the alleged correlation between the LSEs and the ad-load experiments, Pandora points to the absence of any contrary evidence from SoundExchange to refute this alleged correlation. Services RPFCL ¶ 961.

The Judges agree with SoundExchange that Pandora has failed to show the long term effects of a sustained blackout of a Major or other label by Pandora. There is insufficient evidence to support a finding that the results of two unrelated experiments – testing the impact of changing ad-loads and the steering of plays – can be mapped onto the LSEs. The fact that these other experiments may be the only available potential

comparators does not mean that they are useful, or even that they are the best comparators.²⁹⁵

SoundExchange also focuses on an aberrational statistical output from the LSEs. The three-month results showed a [REDACTED] – *i.e.*, this aspect of the LSEs found that listening [REDACTED]. Reiley WDT ¶ 22. Similarly, after six months, the [REDACTED] treatment group showed [REDACTED]. Reiley WRT ¶¶ 12-14 & Fig. 1. Considering these results, Professor Willig found it implausible that “users would listen to Pandora *more* if it lost access to [REDACTED].” Willig WRT ¶¶ 28-29.

According to Dr. Reiley, these results are not statistically significant from a zero effect, and therefore should not be considered anomalous. Reiley WDT ¶ 22 & Fig. 2. Nonetheless, Professor Shapiro discarded the [REDACTED] data, replacing it with the three-month [REDACTED] loss rate, which he noted generated an even greater opportunity cost result. 8/19/20 Tr. 2699 (Shapiro); Shapiro WDT at 22, 27; tbl.4 at 26.

Professor Willig explained why, in his opinion, Professor Shapiro’s substitution of [REDACTED] for [REDACTED] data is inappropriate:

[I]t is completely illogical to reject the results of an LSE applied to one [REDACTED], while simultaneously claiming the results from the same experiment applied to a [REDACTED] are not only reliable, but can be extrapolated to the record company for which the experiment was deemed to be unreliable. None of the LSEs produce results that are statistically different from zero, and as such, Professor Shapiro’s approach amounts to drawing on the random “noise” from one LSE and asserting that such noise constitutes a better estimate of blackout effects than the random noise from

²⁹⁵ Indeed, given Dr. Reiley’s acknowledgement that Pandora has engaged in few longer-term experiments, and did not identify any other such experiments, it is equally true that the ad-load and steering experiments may be the “worst” comparators available. In any event, the concept of “better” or “worse” comparators is meaningless – the experiments are simply inapposite and cannot support Pandora’s attempt to establish credible long-term effects arising from the LSEs.

his other LSEs. This is completely inappropriate and cannot form the basis for reliable results.

Willig WRT ¶ 28.

The Judges agree with Professor Willig’s criticism. Although it was “conservative” for Professor Shapiro to plug in the [REDACTED] data for the [REDACTED] data, that act of purported “fairness” does not make the LSEs reliable. Indeed, because the LSEs also did not include a treatment group blacking-out [REDACTED]’s repertoire (for reasons that Pandora did not explain), Pandora is left with the data generated from the [REDACTED] results to serve as a proxy for the [REDACTED], when the experiment was designed to include [REDACTED]. Although there can be circumstances when information gleaned from only one Major is sufficient, an expert witness cannot simply discard data sources that he believed, *ex ante*, to be necessary, but which, *ex post*, cast doubt on the usefulness of the experiment, in order to paper-over anomalous results.²⁹⁶

In fact, SoundExchange takes Professor Shapiro to task for making other adjustments to the LSE results that it claims are equally *ad hoc* in nature. First, it criticizes Professor Shapiro for attempting to mitigate the real world fall-out (through third-party disclosure of the blackout, discussed *supra*) that would likely ensue upon a blackout of a Major by Pandora by simply relying on the upper end of the 95%

²⁹⁶ Thus, the Judges disagree with Pandora that Professor Shapiro’s discarding of the [REDACTED] data – leaving the LSEs with lost listening data from but one Major ([REDACTED]) – is similar to the Judge’s reliance of industry data from fewer than all three Majors. *See* Services RPFCL ¶ 953. Here, Dr. Reiley and Professor Shapiro constructed an experimental world and established its parameters. When those parameters produced an anomalous result, they discarded it, thereby revising their own experiment. That treatment by a party of data in conflict with the position it advocates resembles a cherry-picking of data, and is quite distinguishable from the Judge’s reliance on real world data from less than all industry participants as probative of the workings of a market.

confidence interval from the LSEs. Professor Willig notes that the upper end of these confidence intervals would be as tainted by the experiments' inability to measure the impact of these real world effects as the point estimates that Professor Shapiro decided to ignore. Alternately stated, the confidence intervals, like the point estimates, are simply unrelated to the real world dissemination of information regarding the blackouts, and thus cannot be invoked as a proxy for the effect of such real world events. *See* 8/5/20 Tr. 581 (Willig); *see also* 8/17/20 Tr. 2335 (Tucker) (finding this adjustment to be "incredibly ad hoc and unreliable" and "anything but conservative"); Tucker WRT ¶ 92 (finding these adjustments "untethered to any valid procedure to produce reliable field experiment estimates"). Moreover, SoundExchange asserts that Professor Shapiro did not present a logical, mathematical or statistical justification for this adjustment. Rather, he instead multiplied the effect of the treatment four times over, a multiple that he testified – in decidedly imprecise language – "[REDACTED]" 8/19/20 Tr. 2704-27 (Shapiro).

In response, Pandora claims that Professor Shapiro never claimed there was a correlation between the impact of the non-disclosure of the label suppression and the parameters of the confidence interval. Services RPFCL ¶ 955. But to the Judges, that response merely underscores SoundExchange's broader criticism – *no aspect of the data arising from the LSEs addresses this non-disclosure problem.*

Accordingly, the Judges are in agreement with the criticism levelled by SoundExchange. The mere fact that Professor Shapiro moved in the direction of greater listening loss by relying on the results at the upper end of the 95% confidence interval is undeniably uncorrelated with the real-world effects of third-party disclosure of the existence of the blackout of a label. As the record testimony and evidence discussed above demonstrates, Pandora proffered no evidence to counter the argument that such a

blackout would likely lead to the cratering of Pandora's listener base, making even Professor Shapiro's quadruple adjustment meaningless.²⁹⁷

ii. Conclusion Regarding the LSEs and the Implication for Professor Shapiro's N-I-N Model

For all of the foregoing reasons, the Judges cannot rely on the LSEs to support Professor Shapiro's calculation of his input "*L*" in his N-I-N model), *i.e.*, the percentage of those performances that would be lost to other forms of listening in the absence of a license from the record company. The failure (or inability) of the LSEs to address the effects of third-party motivated disclosure over the longer-term of the existence of the blackouts on Pandora's listenership, is alone a fatal defect in the LSEs. The other defects catalogued above constitute a further metaphorical "death by a thousand cuts," further supporting the Judges' decision to put no weight on the results of the LSEs. The Judges are in agreement with Professor Willig's testimony that, after considering the foregoing issues, Professor Shapiro's parameter "*L*" is flawed because it is based on unreliable data from the LSEs. Willig WRT ¶¶ 22-27); 8/5/20 Tr. 351-53, 570-74 (Willig) (LSEs are "absolutely not" a reliable source of evidence for use in economic analysis).

Because a useful input "*L*" is a *sine qua non* of Professor Shapiro's opportunity cost calculation within his N-I-N Model, the Judges' decision to reject the calculation of that value (which was intended to show that any one Major is not a "Must Have") renders Professor Shapiro's N-I-N Model unusable.²⁹⁸

²⁹⁷ And, as noted elsewhere in this Determination, for the same reasons, the Judges find that the likely real-world disclosures – from multiple interested sources – of an *interactive* service's blacking-out of a Major would cause a rapid collapse of the interactive service as well ([REDACTED]).

²⁹⁸ Accordingly, the relative merits and criticisms of the other aspects of Professor Shapiro's N-I-N Model are moot.

3. Professor Shapiro's Myerson Value Model

In his rebuttal testimony, Professor Shapiro utilizes what he described as a “Myerson Value” modeling, developed by the economist Roger Myerson, which Professor Shapiro claims is superior to Professor Willig’s “Shapley Value” approach as a form of analysis in this proceeding. More particularly, Professor Shapiro testifies that Myerson Value modeling is similar in nature to the Shapley Value, and in fact can generate values equal to those produced by Shapley Value modeling in certain circumstances. Here, however, Professor Shapiro maintains that the two values depart from one another. The reason for the different outcomes is that the Myerson Value is applicable when there are “contract externalities,” a complication that is not addressed in Shapley Value modeling. Shapiro WRT at 32. By “contract externalities,” Professor Shapiro is referring to a situation where, in the present context, any one notional licensing agreement reached by a Major record company with a noninteractive service would affect the agreements reached by that noninteractive service with the other two Majors. Shapiro WRT at 59.

Professor Shapiro opines that these “contract externalities” would occur *if* the repertoire of each Major was not a “Must Have” for a noninteractive service.²⁹⁹ In this regard, he acknowledges that, for his Myerson Value approach to be relevant (as with his N-I-N model) the Judges would need to find that the Majors are *not* “Must Have” licensors for noninteractive services. *See* 8/19/20 Tr. 2755-56 (Shapiro) (acknowledging

²⁹⁹ *See* Shapiro WRT at 63-64. The external effect is that Major “A” must consider the possibility that agreements between Major “B” and/or “C,” on the one hand, and the noninteractive service, on the other, could result in Major “A’s” inability to enter into a license agreement with that noninteractive service unless Major “A” reduced its royalty demand in order to avoid being the “odd man out.” But, each Major would be in the same position during negotiations, so each Major has the incentive to avoid this “contract externality” by proposing a lower rate than it would in the absence of this bargaining uncertainty.

that the differences between the Shapley Value modeling results and the Myerson Value modeling results would be relatively small if the Majors are indeed “Must Haves” for noninteractive services). Applying this model, Professor Shapiro generates an ad-supported rate of \$0.00146 per play, and a subscription rate of \$0.00155 per play. Shapiro WRT at 63.

The dispositive defect in Professor Shapiro’s Myerson Value modeling is that it too requires the application of the results from the LSEs to demonstrate that no one Major is a “Must Have,” and that bi-lateral negotiations within the model would account for this situation. But, as noted above in the Judges’ discussion of Professor Shapiro’s N-I-N model, an approach that is dependent upon a finding that the Majors are not “Must Haves” for a noninteractive service is in conflict with the Judges’ finding that such a “Must Have” condition exists. Accordingly, the Judges decline to apply Professor Shapiro’s Myerson Value modeling and results.

D. Evaluation of NAB Proposal for a Separate Rate for Commercial

Simulcasters

The NAB participated in this proceeding on behalf of commercial radio stations that simulcast their over-the-air broadcasts on the Internet. In this proceeding, the Judges focus on the Internet transmissions of these broadcasters.

The NAB argues that commercial simulcasting (simulcasting) is distinct from other forms of commercial statutory webcasting. Given the purported differences, the NAB advocates for a separate (lower) rate for simulcasters than for other eligible nonsubscription transmissions by webcasters. The NAB maintains that simulcasting constitutes a distinct submarket in which buyers and sellers would be willing to agree to lower royalty rates than their counterparts in the commercial webcasting market. It proposes a statutory rate of \$0.0008 per play for simulcasts and \$0.0016 for other eligible nonsubscription transmissions. NAB PFFCL ¶ 10. The NAB’s proposal defines a

simulcast transmission as “a public performance of a sound recording by means of the simultaneous or near-simultaneous retransmission, as part of an eligible nonsubscription transmission, of the same sound recording included in a ‘broadcast transmission,’ as the term is defined in 17 U.S.C. 114.” NAB Proposed Rates and Terms at 8.

The NAB broadly contrasts simulcasting with custom radio services, which, it asserts, are standalone products, untethered to a corresponding radio broadcast. Leonard WDT ¶ 33. It indicates that custom radio provides a personalized experience that reflects a specific user’s preferences. Leonard WDT ¶ 33; 8/18/20 Tr. 2430-31 (Tucker); *see also* 8/13/20 Tr. 1819 (Orszag). The NAB adds that such services also permit more interactivity than simulcasts, such as seeding stations, skipping to another song, and thumbing up or down, all of which curate the listening experience. 8/24/20 Tr. 3427 (Leonard); Leonard WDT ¶ 49; Leonard WRT ¶¶ 41-47.

Dr. Leonard, whom the NAB engaged to analyze the appropriate statutory royalty for public performance rights for sound recordings for webcasting under the Section 114 license and to evaluate the NAB’s proposal regarding that statutory royalty, set out three types of webcasting services subject to the Section 114 license: Simulcast, Custom Radio, and Internet Radio. Leonard WRT ¶¶ 32-35. His stated criteria for simulcasts tracks closely to the proposed regulatory definition offered by the NAB. Dr. Leonard characterized custom radio as a service that “streams music to listeners over the Internet without any simultaneous terrestrial broadcast. Unlike simulcasts, custom radio is a ‘one to one’ stream, with a particular listener receiving an individualized stream reflecting his or her expressed preferences, subject to the limitations on ‘interactivity’ imposed by the Section 114 license, as interpreted by U.S. courts.” Leonard WRT ¶ 33.

He characterized internet radio as “a ‘native digital’ service [that] does not involve the retransmission of a terrestrial broadcast.” Leonard WRT ¶ 34. He went on to state that internet radio is more similar to custom radio than to simulcast and that, while

internet radio stations do not vary the music played based on an individual listener's preferences, such services nonetheless often feature greater user functionality than simulcast, such as allowing listeners to pause and skip songs. He also maintained that internet radio services do not feature much non-music or localized content, nor are they subject to FCC regulation or public interest requirements. He also asserted that internet radio services are not a significant part of the streaming market and noted that his report does not treat internet radio services as distinct from custom radio services. Leonard WRT ¶ 35.

As the proponent of a rate structure that treats simulcasters as a separate class of webcasters, the NAB bears the burden of demonstrating not only that simulcasting differs from other forms of commercial webcasting, but also that it differs in ways that would cause willing buyers and willing sellers to agree to a lower royalty rate in the hypothetical market. *Web IV*, 81 FR at 26320. As discussed below, based on the record in the current proceeding, the Judges find that the NAB has not satisfied that burden. Therefore, the Judges do not adopt a different rate structure for simulcasters than that which applies to other commercial webcasters.

1. **History**

No prior rate determination has treated simulcasters differently from other webcasters. In *Web I*, the Librarian, at the recommendation of the Register, rejected a CARP report that set a separate rate for retransmission of radio broadcasts by a third-party distributor and adopted a single rate for commercial webcasters. 67 FR at 45252.³⁰⁰

In *Web II*, the Judges rejected broadcasters' arguments that rates for simulcasting should be different from (and lower than) royalty rates for other commercial webcasters.

³⁰⁰ The Librarian also rejected arguments that broadcasters who stream their own radio broadcasts should be treated differently from third parties who stream the same broadcasts. *Id.* at 45254.

72 FR 24084, 24095 (May 1, 2007), *aff'd in relevant part sub nom. Intercollegiate Broad. Sys. v. Copyright Royalty Bd.*, 571 F.3d 69 (D.C. Cir. 2009) (*Web II*).

The NAB reached a WSA settlement with SoundExchange prior to the conclusion of *Web III* covering the remainder of the *Web II* rate period and all of the *Web III* rate period. At the request of the NAB and SoundExchange, the Judges adopted the settlement as statutory rates and terms binding all simulcasting broadcasters. See 75 FR 16377 (April 1, 2010). Consequently, simulcasters did not participate in the *Web III* proceeding, in which the Judges determined rates for “all other commercial webcasters.” Although the Judges did not determine separate rates for simulcasters in *Web III*, because the Judges adopted the NAB settlement, simulcasting broadcasters paid different rates than webcasters that operated under the rates determined by the Judges.

In *Web IV*, the Judges also rejected broadcasters’ arguments that rates for simulcasting should be different from (and lower than) royalty rates for other commercial webcasters. 81 FR at 26323.

2. Proposed Benchmark Agreements

In the current proceeding, the NAB offered proposed benchmark agreements in support of its rate proposal, supplemented by an alternative economic analysis. The NAB offered different types of voluntary agreements in support of its proposal: direct license agreements between sound recording rights owners and webcaster iHeart and license agreements for musical compositions between performing rights organizations and webcasters Pandora and iHeart.

a. The iHeart/Indie Agreements

The NAB sets forth as proposed benchmarks a set of 16 renewed direct license agreements between iHeart and independent (“indie”) record labels that include rights for simulcasting and other webcasting. Exs. 2013-2026, 2081-2082 (the iHeart/Indie Agreements). The NAB’s economist, Dr. Leonard, accurately indicated that the terms

and conditions of iHeart's direct deals with indies are generally consistent across all of these agreements. Leonard WDT ¶ 63. The NAB argues that these agreements provide insight into how willing buyers and willing sellers license simulcast and custom radio streams on different terms. 8/24/20 Tr. 3355 (Leonard); Leonard WDT ¶ 65; Trial Ex. 2154 ¶ 14 (WDT of James Russell Williams III ("Tres Williams")) (Williams WDT).

The NAB maintains that the iHeart/Indie Agreements are the only willing buyer / willing seller agreements offered by any participant that are between statutory services and sound recording companies for the same rights at issue under the section 114/112 licenses. 8/24/20 Tr. 3375-76 (Leonard); *see also id.* at 3355; Leonard WDT ¶ 65. Dr. Leonard focused his analysis on the renewal agreements because he concluded that these agreements indicate that the effective per-play rates under those agreements were acceptable to both parties and that the iHeart-Indie benchmarks are the best evidence of a willing buyer / willing seller transaction at the effective per-play rates that predated the renewal. Leonard WRT ¶ 50; Leonard WDT ¶ 65; 8/24/20 Tr. 3357-58.

The NAB argues that the iHeart/Indie Agreements reflect licensors' views of the relative promotional and substitutional considerations associated with licensing iHeart's simulcast and custom radio services and generate average rates below the statutory rate. Leonard WDT ¶ 71, 75. In the NAB's view, the indie labels' willingness to accept below-statutory rates was motivated by steering, including both the ability to garner more plays of the indies' catalogs and special relationships with top programmers at iHeart. 8/31/20 Tr. 4538-39; 4542-43 (Williams).

SoundExchange asserts that the iHeart/Indie Agreements are not a reliable or appropriate benchmark. It points out Dr. Leonard's acknowledgement that the iHeart/Indie Agreements account for only [REDACTED]%, [REDACTED]%, and [REDACTED]% of iHeart's total simulcast, custom radio, and webcast performances, respectively. Leonard WDT ¶ 72 & app. A4. SoundExchange maintains that the scope

of these licenses makes them insufficiently representative to serve as persuasive benchmarks, citing the Judges' decision, in *SDARS III*, not to use as a benchmark a far larger number of direct licenses with indie record labels, 500 direct licenses representing 6.4% of the tracks on Sirius XM playlists because they were not representative of the market. *SDARS III*, 83 FR at 65249.

SoundExchange also criticizes the persuasiveness of the iHeart/Indie Agreements because the agreements [REDACTED] 8/24/20 Tr. 3492 (Leonard). SoundExchange adds that all but two of the agreements [REDACTED]. Orszag WRT ¶ 59.

SoundExchange also maintains that under the iHeart/Indie Agreements, iHeart had little incentive to steer plays toward the contracting indie labels' content. It cites to Dr. Leonard's acknowledgment that broadcasters' choice of content is driven not by simulcasting but by terrestrial radio choices and the considerations there. 8/24/10 Tr. 3503 (Leonard).³⁰¹

SoundExchange adds that [REDACTED]. SX PFFCL ¶¶ 1181-1182; Orszag WRT ¶ 59.

SoundExchange asserts that the iHeart/Indie Agreements do not fully account for the economic value of simulcasting to the parties. It maintains that the indie labels that entered into the iHeart/Indie Agreements received several other benefits not available under the statutory license in exchange for accepting a lower royalty rate. Orszag WRT ¶ 62. It asserts that these motivating factors serve as key differentiators between direct license agreements and the statutory environment and that taking royalty rates from direct licenses at face value would distort the estimate of overall market rates. Orszag WRT ¶ 68.

³⁰¹ 17 U.S.C. 114(g)(2) requires that SoundExchange distribute 50% of collected license fees to the copyright owner of a sound recording, 45% to recording artist or artists featured on such sound recording, and the remaining 5% to independent administrator that represents non featured musicians and vocalists who have performed on sound recordings.

SoundExchange indicates that the labels entering into the iHeart/Indie Agreements were motivated by [REDACTED]. Orszag WRT ¶¶ 65. The agreements include payments that are characterized [REDACTED]. *See, e.g.*, Trial Ex. 2013 ¶¶ 1(j), 1(g)(g), and 4(a)(i) The U.S. copyright law confers no exclusive right of public performance by means of terrestrial radio transmissions for sound recording copyright owners. Mr. Orszag [REDACTED] Orszag WRT ¶¶ 66. Mr. Orszag argued that a label whose catalog performs better on terrestrial radio than it does on simulcasting or custom webcasting might expect [REDACTED]. *Id.* He added that several indie labels generally [REDACTED], or [REDACTED]. Orszag WRT ¶¶ 66 n.139. Mr. Orszag also indicated that in addition to the financial benefits, this [REDACTED] served as an [REDACTED]. *Id.* ¶ 65; 8/31/20 Tr. 4606-07 (Williams) (acknowledging that “[REDACTED]”).

SoundExchange also argues that the labels entering into the iHeart/Indie Agreements direct license were motivated by royalties for pre-1972 catalog, something the labels were not otherwise entitled to prior to the passage of the Music Modernization Act in 2018. Orszag WRT ¶¶ 67.

SoundExchange notes that the iHeart/Indie Agreements enabled indie labels to both avoid deduction of SoundExchange’s administrative fee and capture the full amount of royalties owed by iHeart, without any mandatory share of royalties under the iHeart/Indie Agreements going directly through SoundExchange to featured or non-featured performing artists, as would have been the case under the statutory license. 8/13/20 Tr. 1852-53 (Orszag); Orszag WRT ¶ 63. The NAB elicited testimony from Mr. Orszag indicating that he was aware of only one of the indie labels that agreed to the iHeart/Indie Agreements, [REDACTED], which primarily focuses on budget classical music, that [REDACTED]. 8/13/20 Tr. 1853 (Orszag). Mr. Orszag indicated that one of the indie labels that agreed to the iHeart/Indie Agreements, [REDACTED], may still employ splits with certain artists, equal to or proximate to the 50/50 split due to

performing artists under the statutory license. However, he did not represent that he knew know all of [REDACTED]'s deals with its artists, or the share of royalties that artists may be due. 8/13/20 Tr. 1855-57 (Orszag).³⁰²

b. The PRO Agreements

The NAB offers agreements licensing public performance rights in musical works to webcasters as a providing evidence to reinforce the conclusion that simulcast should receive a lower royalty rate than custom radio. Leonard WDT ¶ 83, 89. The NAB argues that agreements between performance rights organizations and webcasters indicate that simulcast and custom radio exist as distinct products subject to different rates in voluntary agreements. 8/24/20 Tr. 3389-91 (Leonard); Leonard WDT ¶ 81.

Dr. Leonard referenced a 2017 ASCAP Radio Station License Agreement with iHeart. He represented that the license includes coverage for simulcasts and certain non-simulcast webcasts but excludes coverage for custom radio webcasts that offers music programming customized for any specific user or enables a user to provide feedback to customize the music programming made available to such specific user. Leonard WDT ¶¶ 85-86. Dr. Leonard maintained that this ASCAP license is informative because: the radio stations licensees offering simulcast services are the same licensees at issue in this proceeding; the license covers analogous rights, for performance of musical compositions as compared to performance of sound recordings; the license covers simulcast and non-simulcast (non-custom) Internet radio, [REDACTED]; the agreement is a transaction negotiated under the competitive protections of the ASCAP antitrust consent decree; and

³⁰² The iHeart/Indie Agreements include substantially similar language indicating that the relevant label “[REDACTED].”

All but one of the iHeart/Indie Agreements, the [REDACTED] Agreement, Trial Ex. 2027, went on to clarify that “[REDACTED]” *See, e.g.*, [REDACTED] Agreement, Trial Ex. 2013 ¶ 4b.

it functions as an industrywide agreement. Leonard WDT ¶ 87. Dr. Leonard testified [REDACTED], so he compared the ASCAP license's percentage of revenue rate for simulcasts with an effective Pandora royalty, which he calculated as a percentage of revenue. Leonard WDT ¶ 88; 8/24/20 Tr. 3390 (Leonard). His analysis indicated that the ratio of the ASCAP royalty rate as a percentage of revenue for simulcast to the ASCAP royalty rate as a percentage of revenue for Pandora ranges from 38% to 48%. Leonard WDT ¶ 88.

Dr. Leonard represented that BMI has offered to the Radio Music License Committee³⁰³ a percentage of revenue royalty rate for terrestrial broadcasts simulcast and certain limited non-simulcast non-custom streaming. He maintained this is an indication that BMI treats simulcasting as equivalent to radio stations' terrestrial broadcasts. Leonard WDT ¶ 89. He also acknowledges that the RMLC did not request and BMI did not offer a rate for custom radio. Leonard WDT ¶ 90. Dr. Leonard also indicated that a group of radio stations represented by the RMLC entered into licenses with the PRO SESAC covering the period from January 1, 2016 to December 31, 2018 that provided a percentage of revenue royalty rate for terrestrial broadcasts and simulcast. Leonard WDT ¶ 91.

The NAB also argues that litigation with ASCAP and BMI over the royalty rates it was required to pay to those PROs for its custom radio product indicates that custom radio services are not similarly situated to radio stations' product, and that the two services are not "similarly situated" under the ASCAP consent decree but are "different types of services." SX PFFCL ¶¶ 90-91; *see In re Pandora Media, Inc.*, 6 F. Supp. at 320; *BMI v. Pandora Media, Inc.*, 140 F. Supp. 3d 267, 270 (S.D.N.Y. 2015).

³⁰³ The Radio Music License Committee represents the interests of the commercial radio industry on music licensing matters.

SoundExchange counters the NAB's arguments regarding the PRO agreements by asserting that it is not informative that custom webcasting is generally licensed separately and at a higher rate because licensees pay the PROs on a percentage of revenue basis.

8/24/20 Tr. 3534-35 (Leonard). SoundExchange notes that Dr. Leonard acknowledges that radio broadcasters typically play less music per hour than custom webcasters, and the percentage-of-revenue rates paid to the PROs by simulcasters would reasonably be lower than the rates paid to the PROs by custom webcasters. *See, e.g.*, Leonard WDT ¶ 39 & app. C2-C18; *see also* 8/24/20 Tr. 3535-36 (Leonard); Orszag WRT ¶ 48.

SoundExchange maintains that the different intensities of music use explain the different effective percentage of revenue rates in PRO agreements for simulcast and custom radio. Orszag WRT ¶¶ 50-51.

SoundExchange adds that the NAB did not actually submit into the record any operative agreement between any PRO and any webcaster that covers *custom radio* and that NAB's claimed evidence about what custom radio pays is from unseen agreements between Pandora and two PROs is inadequate. SX PFFCL ¶¶ 1096-97; 8/24/20 Tr. 3541, 3542 (Leonard). SoundExchange argues that Dr. Leonard does not know what the agreements actually say and he cannot say whether the rates for custom webcasting reflect potential tradeoffs on other terms. SX PFFCL ¶¶ 1097-99. SoundExchange adds that Dr. Leonard admitted that he did not know if there were such tradeoffs or how they were negotiated because he had not actually seen the agreements. 8/24/20 Tr. 3542, 3551 (Leonard).

SoundExchange then argues that the definitions regarding "similarly situated" licensees in the ASCAP and BMI consent decrees include factors that are distinct from the provisions of 17 U.S.C. 114(f)(1)(B). SoundExchange maintains that the differences between the consent decrees and the statute explain why PROs treat custom radio differently from broadcast and simulcast. It notes that the ASCAP consent decree

expressly identifies, “the nature and frequency of musical performances” as a factor to identify whether services are similarly situated, and states that similarly situated services “use music in similar ways and with similar frequency.” SX RPFCL (to NAB) ¶ 102, citing *United States v. ASCAP*, No. 41-1395 (WCC), 2001 WL 1589999, at *3 (S.D.N.Y. June 11, 2001).

3. Conclusions Regarding Benchmark Evidence for Simulcasting as Distinct from Other Forms of Statutory Webcasting

a. iHeart/Indie Agreements

Based on the entirety of the record, the Judges do not accept the iHeart/Indie Agreements as sufficiently probative of the relevant market to accept them as meaningful or persuasive benchmarks, or therefore as adequately persuasive to establish a separate rate for simulcasting. Importantly, these direct licenses cover only a small portion of the sound recordings performed by iHeart, and an even smaller portion of the entire market for simulcast, custom radio, and Internet radio performances. The Judges also find that the record is insufficiently informative as to the effect of steering on the agreed upon royalty rates because none of them contain [REDACTED]. In addition, because U.S. copyright law confers no exclusive right of public performance by means of terrestrial radio transmissions for sound recording copyright owners, or prior to passage of the MMA a right to royalties for pre-1972 sound recordings, the Judges have misgivings regarding the extent to which the royalties under the agreements accurately reflect the myriad of motivations, and value received, for labels to enter into them. In sum, the characterization of part of the compensation in these agreements [REDACTED] is suspect, as it is not economically rational for a licensee to pay a royalty for an activity for which no license is required. The

NAB has not sustained its burden to provide an adequate basis in evidence or economic theory that would permit the Judges to allocate this compensation accurately.³⁰⁴

The Judges find that SoundExchange offered compelling indications that the indie labels that entered into the iHeart/Indie Agreements were motivated by non-monetary benefits that undermine the application of the agreements as reliable benchmarks. The Judges find that the NAB did not adequately counter or account for these concerns.

SoundExchange also raised legitimate concerns that several indie labels generally [REDACTED], or [REDACTED], on the [REDACTED] of the direct licenses across multiple monthly royalty statements, thus skewing the motivations of the Indie labels, especially in the context of payments for unrecognized rights under U.S. copyright law. The NAB did not present the Judges with adequate evidence to address or account for these legitimate concerns.

The Judges observe, and find concern with the fact that while the NAB's proposal seeks to contrast simulcasting with all other statutory webcasting, the NAB chose to more consistently draw a contrast between simulcasting and custom radio services, by treating Internet radio, without adequate justification, as indistinct from custom radio. The Judges find that this conflating of Internet radio and custom radio services was not adequately supported by the record evidence, and that therefore the proper comparison between simulcasting and all other statutory commercial webcasting was insufficiently established.³⁰⁵

³⁰⁴ While Dr. Leonard's analysis of the iHeart/Indie Agreements offered adjustments that considered allocating various levels of revenue [REDACTED]. The Judges would need further evidence to determine whether and the extent to which, as an economic matter, [REDACTED] should be treated as compensation for simulcasting, in contrast to custom webcasting.

³⁰⁵ The Judges also observe, but do not necessarily rely upon, the apparent ability of the [REDACTED]. While there was an indication that some labels and artists agreements, in particular a notably successful

b. PRO Agreements

Based on the entirety of the record, the Judges find that evidence regarding agreements between performance rights organizations and webcasters is insufficiently persuasive to establish that simulcast and custom radio exist as distinct products subject to different rates in voluntary agreements. As an initial matter, the Judges note that PRO negotiations and agreements cover different rights, and involve different parties from those at issue in this proceeding. It is also relevant that the rights at issue are often subject to detailed on-going government oversight via consent decrees. The Judges are in agreement with SoundExchange that the definitions regarding “similarly situated” licensees in the ASCAP and BMI consent decrees include factors that are distinct from the provisions of 17 U.S.C. 114(f)(1)(B).

In addition, the Judges find it troubling that the NAB did not actually submit into the record any operative agreement between any PRO and any webcaster that covers custom radio. The Judges find the NAB’s claimed evidence about what custom radio pays, purportedly derived from unseen agreements between Pandora and two PROs, to be inadequate and unreliable. SoundExchange correctly points out that neither the NAB nor the Judges can know what the agreements actually say, and whether the agreements may reflect tradeoffs on other terms.

recording artist group, may employ artist share splits equal to or proximate to the 50% share due to performing artists under the statutory license, the Judges have sparse indication regarding the range or frequency of actual artists’ shares that may be equal to or proximate to the statutory 50/50 split. The Judges also note that the [REDACTED] Agreements [REDACTED]. *See e.g.*, [REDACTED] Agreement, Ex 2013, ¶ 4b. This is in contrast to at least one other agreement in evidence covering webcasting uses eligible for the 114 statutory license, the 2016 Pandora/UMG agreement, which indicates an obligation for UMG to “[REDACTED],” Ex 5013, SOUNDEX_W5_000010111.

4. Qualitative Arguments regarding a Separate Rate for Simulcasters

In addition to its proposed benchmarks, the NAB offers several qualitative arguments why willing buyers and sellers would agree to lower simulcasting rates. For the reasons set forth below, and based on the entirety of the record, the Judges are not persuaded that the offered qualitative arguments sufficiently establish that willing buyers and sellers would agree to separate, lower simulcasting rates.

a. Degree of Interactivity

The NAB argues that simulcasters should pay a lower royalty because simulcast transmissions are among the least interactive form of webcasting. NAB PFFCL ¶¶ 147-153. It asserts that in establishing a digital performance right for sound recordings and the statutory license at issue, Congress recognized that “interactive services are most likely to have a significant impact on traditional record sales” while noninteractive services were more promotional and less substitutional. NAB PFFCL ¶ 148 (citing H.R. Rep. No. 104–274, at 14). The NAB suggests that this legislative history indicates Congress’s recognition that a service’s interactivity is a good proxy for its ability to substitute or interfere with other streams of revenue. Leonard WDT ¶ 49. It points to the Copyright Office’s recognition that “it may be appropriate [for the Judges] to distinguish between custom and noncustom radio, as the substitutional effect of personalized radio on potentially competing interactive streaming services may be greater than that of services offering a completely noncustomized experience.” NAB PFFCL ¶ 149 (citing *Copyright and the Music Marketplace, supra* at 178). The NAB also offers the testimony of Aaron Harrison, Senior Vice President, Business and Legal Affairs of UMG Recordings, who agreed that typically “[REDACTED]” 9/3/20 Tr. 5691 (Harrison).

As a record company executive, Mr. Harrison’s testimony provides some evidence that record companies [REDACTED] because those services are less likely to displace sales of sound recordings. However, the value of his statements for determining

whether a differential rate is justified for simulcasters is limited. First, Mr. Harrison was not addressing specific negotiations or transactions. Second, the series of questions Mr. Harrison was responding to were focused on additional functionality of directly licensed *interactive* services. 9/3/20 Tr. 5690-92 (Harrison). Mr. Harrison clarified this in his testimony stating his understanding that UMG has only licensed “[REDACTED].” 9/3/20 Tr. 5691 (Harrison).

While the NAB posits that simulcasting is less interactive than custom webcasting, it has not established that simulcasting, *as a rule*, is materially less interactive than the full scope of noninteractive webcasting, all of which would be subject to the general commercial webcasting rates. The statutory license is available to services that offer a continuum of features, including various levels of interactivity, which are offered in a manner consistent with the license. While the Judges recognize, as have others, that a variety of factors *may* support a separate rate, on the record before them, the Judges find insufficient basis for parsing the interactivity across statutory services as proposed, or to set a customized rate structure among categories of commercial webcasters based on statutorily permissible levels of interactivity.

b. Promotional Effect

The record includes numerous statements concerning the specific promotional value to copyright owners of terrestrial radio plays for stimulating revenue for sound recordings, thus leading to a licensee’s willingness to accept lower rates for such plays. *See, e.g.*, 9/3/20 Tr. 5734 (Harrison); Trial Ex. 2153 at 7-19 (WDT of Tom Poleman) (Poleman WDT); 9/9/20 Tr. 5944 (Sherwood); Leonard WRT ¶¶ 97-101. The record also indicates that characteristics that enhance promotional value include tight playlists with limited recordings and repeated plays of recordings on those playlists. Additionally, the record includes some indication that labels may not distinguish the between terrestrial

radio versus simulcasting in terms of promotional benefit. Poleman WDT ¶¶ 7; 8/27/20 Tr. 4418-19.

The bulk of the evidence is persuasive that labels perceive a distinct promotional value in over the air radio play of their recordings, including participation in certain promotional programs and opportunities to enhance their ability to leverage promotional plays on terrestrial radio, with some necessary tie-in to simulcast plays. However, the record provides little persuasive indication that labels similarly, affirmatively, seek plays over simulcasts for purposes of promotion. The indications that labels may not distinguish the between terrestrial radio versus simulcasting in terms of promotional benefit is reasonably indicative that labels simply do not consider the promotional value of simulcasts (which reaches a relatively small number of listeners) in their pursuit of the promotional value of terrestrial radio plays. The NAB fails to analyze adequately the degree to which labels assign promotional value, or take actions motivated by promotional value of simulcasts in relation to the promotional value labels seek via terrestrial plays.

c. The Value of Non-Music Content as a Differentiator

The NAB points to simulcasts' differentiated use of music versus non-music content, compared to custom radio, which is geared more toward music content. NAB PFFCL ¶¶ 165-167. It sets forth that terrestrial radio and simulcasters play relatively few songs compared to custom radio services. NAB PFFCL ¶ 167; Leonard WDT ¶ 47; 8/24/20 Tr. 3427:3-8 (Leonard) (“[terrestrial broadcasters and simulcasters] use forms of non-music content to compete in the marketplace ... in contrast, a custom radio station is basically 100 percent music.”). It adds that terrestrial radio and simulcasters play relatively small catalogs of songs compared to custom radio services and that as a result any particular sound recording is not significantly important for the transmitted programming. NAB PFFCL ¶ 167; 9/3/20 Tr. 5734 (Harrison); Leonard WDT ¶ 45. The

NAB also offers that radio stations receive the most ad revenue during parts of the day where they play the least music, as an indication that terrestrial radio and simulcasters value non-music content less. 8/24/20 Tr. 3429-31 (Leonard). It also suggests that audience surveys and proposed benchmark agreements (addressed above) indicate that listeners place a relatively high value on non-music content. The NAB maintains that taken together this “evidence suggests music content has less value per minute, and therefore less value per-play, on simulcast than on custom radio.” NAB PFFCL ¶ 172.

Like the NAB’s proposed analysis of promotional value, its arguments regarding differentiated use of music versus non-music content by terrestrial radio and simulcasters compared to custom radio are insufficient. Both analyses fail adequately to address the relative motivations behind programming choices as they may apply to terrestrial radio versus simulcasting, and extent to which each transmission method plays a role in programming choices. Additionally, the bulk of the evidence and analysis regarding differentiated use of music versus non-music content involves comparison of simulcasts and *custom radio*, the latter of which is merely a subset of other eligible nonsubscription transmissions. This type of evidentiary comparison does not match with the proposal to differentiate rates between simulcast and *all other* eligible nonsubscription transmissions. While the NAB posits that simulcasts are able to differentiate by use of non-music content and that simulcasters play relatively few songs compared to custom radio, it has not adequately established that simulcasting, *as a rule*, is materially less music intensive than the full scope of noninteractive webcasting, all of which would be subject to the general commercial webcasting rates.

d. Competition with other commercial webcasters

SoundExchange argues that simulcasters and other commercial webcasters compete for listeners and revenue in the same submarket and therefore should be subject to the same rate. It cites to numerous statements in government filings submitted by

broadcasters and the NAB in support of this position. *See, e.g.* NAB 2018 comments filed with the FCC (Trial Ex. 5472) (acknowledging radio broadcasters have myriad competitors for streaming audiences); Cumulus Media, Inc. December 31, 2019 SEC filing Form 10-K (Trial Ex. 3042) at 8 (discussing competition with various digital platforms and services, including streaming music and other entertainment services for both listeners and advertisers). Additionally, SoundExchange points to internal NAB and iHeart documents indicating that broadcasters view digital music services as competitors. *See, e.g.* NAB Board Meeting Minutes from January 29, 2018 (Trial Ex. 5196) at 3 (discussing “[REDACTED]”). SoundExchange also offers evidence that certain webcasters affirmatively seek to compete with simulcasters as well as terrestrial radio, including [REDACTED]. Trial Ex. 5056 at 73. The Judges find these indications of mutual competition between simulcasters and other commercial webcasters to be a compelling indication that simulcasters and other commercial webcasters operate in the same, not separate submarkets.

5. Survey Evidence Regarding Separate Rate for Simulcasters

a. The Hauser Survey

The NAB engaged Professor John Hauser to determine the degree to which listening to simulcasts substitutes for various alternative activities, the importance of different types of content to simulcast listeners, and how much consumers listen to simulcasts. *See* Trial Ex. 2151 ¶¶ 6-7, app. E (WDT of John Hauser) (Hauser WDT); 8/27/20 Tr. 4333-35 (Hauser). Professor Hauser’s survey results are expressed as a series of “diversion ratios” reflecting the percentage of respondents that, in the absence of simulcasts, would consume content from the potential alternative activities presented in the survey. Hauser WDT app. R.

Professor Hauser indicated that his survey employed standard scientific methods to maximize reliability. The method included Screening Questions to ensure an appropriate target audience and attention checks to verify that respondents read the

survey questions carefully. He also used a double-blind methodology and included question and response options unrelated to the study's objective and used filters and randomization of response options (when appropriate) to avoid certain biases. Hauser WDT ¶¶ 14, 22-24, 39.

After screening for the appropriate target sample audience, 536 respondents moved to the main survey. Of that group of qualified respondents, 532 completed the survey. Professor Hauser testified that this sample size was adequate to enable him to provide statistically significant results. Hauser WDT ¶ 76.

In an introduction to the survey, the respondents were instructed that "There are various ways in which you can listen to content, some of which are defined below. Please read these definitions carefully, and keep them in mind when responding to questions in this survey." The descriptions of the listening options were:

Live AM/FM radio broadcasts through a radio: Live AM/FM radio is broadcast locally, thus allowing listeners to listen to local stations that may offer news, sports, weather, talk, and/or music through an AM/FM radio that is portable, in the home, or built into a car. Stations may broadcast programming created locally (*e.g.*, morning shows with local traffic and weather), or nationally. Radio stations may be not-for-profit (*e.g.*, NPR, college radio stations) or commercially supported by ad sales (commercial radio).

Live AM/FM radio broadcasts over the Internet: Live AM/FM radio broadcasts over the Internet allow listeners to listen to the same content through their computers or other Internet-capable devices that is simultaneously transmitted to AM/FM radios. Live AM/FM radio broadcasts over the Internet may be accessed by going to the website or app of a radio station, or to the website or app for a platform such as iHeartRadio or TuneIn.

Satellite radio (SiriusXM): Satellite radio is broadcast nationwide via satellite, thus allowing listeners to listen to the same stations anywhere in the country through a receiver that is portable, in the home, or built into a car. Satellite radio is available by subscription and offers commercial-free music as well as sports, news, talk, and other programming. Satellite radio may offer different stations that are not available on live AM/FM radio broadcasts through a radio or over the Internet.

On-demand music streaming services: On-demand music streaming services allow listeners to choose the specific song, artist, or playlist they wish to hear, in addition to playlists provided by the service. These services

may be available for free with ads, or through a paid subscription without ads. On-demand music streaming services include Apple Music, ad-supported Spotify, Spotify Premium, Google Play Music, and others.

Not-on-demand music streaming services: Not-on-demand music streaming services do not allow listeners to choose the specific song or artist they wish to hear, but instead provide a pre-programmed list of songs based on listener preferences. The specific planned selection and order of songs remain unknown to the listener (*i.e.*, no prepublished playlist). These services may be available for free with ads, or through a paid subscription without ads. Not-on-demand music streaming services include ad-supported Pandora, Pandora Plus, and others.

Hauser WDT app. D-6-7. At various points in the survey, respondents were informed they may click a link to review these definitions. *See, e.g.* Hauser WDT app. D-11.

The first question in the main survey, Q1, asked respondents to approximate the total number of hours they spent listening to live AM/FM broadcasts from commercial radio stations over the Internet over the prior three days. Hauser WDT ¶ 93.

On average, respondents estimated that they spent 5.3 hours listening to Internet simulcasts of terrestrial commercial radio during the past three days (approximately 1 hour per day). The median respondent estimated spending four hours listening to Internet simulcasts of terrestrial commercial radio during the past three days—approximately 1.5 hours per day. A total of 91.6 percent of the respondents spent less than twelve hours over three days (*i.e.*, four hours per day) and 96.7 percent spent less than eighteen hours over three days (*i.e.*, six hours per day). Three respondents spent more than ten hours per day and no respondents spent more than forty-eight hours over the three-day period. The average estimated number of hours spent listening to Internet simulcasts of terrestrial commercial radio by day of week ranged from 1.7 to 1.8 hours. Hauser WDT ¶¶ 94-95.

The next question, Q2, asked respondents about the types of content to which they listened on Internet simulcasts of terrestrial commercial radio. Respondents were prompted to select all of the offered types of content to which they listened on Internet simulcasts of terrestrial commercial radio in the last three days. Hauser WDT ¶ 96. The offered types of content were as follows:

- Music (all genres, *e.g.*, pop country rock children’s music religious music)
- Sports (*e.g.*, game broadcasts commentary)
- News weather and traffic
- Religion (nonmusic content, *e.g.*, preaching education)
- Talk (*e.g.*, live DJ commentary politics personal finance)
- Comedy (*e.g.*, sketch comedy stand up)
- Kids and family nonmusic content (*e.g.*, educational programs)
- Other content. Please specify [TEXT BOX DO NOT ALLOW
BLANKANCHOR GO TO Q4 IF ONLY OTHER IS SELECTED ANCHOR]
- Don’t know/Unsure [EXCLUSIVE ANCHOR] [IF “DON’T
KNOW/UNSURE” IS SELECTED GO TO Q4 OTHERWISE GO TO Q3]

Hauser WDT app. D-10.

On average, respondents indicated that they listened to 2.6 types of content on Internet simulcasts of terrestrial commercial radio in the last three days. The breakdown was as follows: 413 respondents (82.4 percent) selected music; 277 respondents (55.3 percent) selected news weather and traffic; 248 respondents (49.5 percent) selected talk; 182 respondents (36.3 percent) selected sports; 89 respondents (17.8 percent) selected comedy; 34 respondents (6.8 percent) selected religion; 32 respondents (6.4 percent) selected kids and family; and 2 respondents (0.4 percent) selected other content types.

Hauser WDT ¶ 97.

Appendix O, displays a table of the results.

If respondents indicated that they listened to one or more types of content in the past three days, they were next asked, in Q3, to indicate the level of importance each type of content had for them, choosing between “not important,” “somewhat important,” and “very important” for each type of content. Hauser WDT ¶ 99.

A total of 256 (51.1 percent) indicated music was very important, 185 (36.9 percent) indicated news, weather and traffic was very important, 123 (24.6 percent) indicated talk content was very important, 99 (19.8 percent) indicated sports content was

very important, 45 (9.0 percent) indicated comedy was very important, 22 (4.4 percent) indicated religious content was very important, and 18 (3.6 percent) indicated that kids and family content was very important. Hauser WDT ¶ 100.

Appendix P, displays a table of the results.

The respondents were then asked, in Q4, about options they would consider in place of Internet simulcasts as follows:

Now suppose that live AM/FM radio broadcasts **from commercial radio stations over the Internet** were not available for the next five years. Assume that everything else would be available for the next five years as it is now. Which of the following if anything would you consider doing **in place of** listening to **such broadcasts over the Internet** during the next five years? The prices below are examples and do not include promotional discounts taxes or fees. If you are unable to say whether you would do or would not do a particular activity please indicate this by choosing the ‘Don’t know Unsure’ option. It is important that you do not guess.

Hauser WDT ¶¶ 101-104, app. E, Q4

Then, in Q5, respondents were asked, out of the selected consideration set, which option they *would choose*, as follows:

Continue to suppose that live AM/FM radio broadcasts from commercial radio stations over the Internet were not available for the next five years. Assume that everything else would be available for the next five years as it is now. Now think about the most recent time you listened to live AM/FM radio broadcasts from commercial radio stations over the Internet. Please consider situations similar to that time and the content you listened to at that time. Which one of the following would you do in place of listening to such broadcasts over the Internet in similar situations during the next five years. The prices below are examples and do not include promotional discounts taxes or fees. If you are unable to say which particular activity you would do please indicate this by choosing the ‘Don’t know / Unsure’ option. It is important that you do not guess.

Hauser WDT ¶¶ 101-105, app. E, Q5.

Professor Hauser indicated that the consider-then-choose question formulation served two functions. First, the question serves a filter. Respondents cannot select a medium if they would not at least consider it. By using such a filter, the survey avoids asking respondents to guess about which medium they would choose. Second, Professor Hauser represented that there is strong scientific evidence that consumers use a two-stage

consider-then-choose decision process when they make a consumption decision, and that this format is more realistic and provides a better representation of the decision processes that consumers use. Hauser WDT ¶¶ 102.

The options in Q4 and Q5 were as follows³⁰⁶:

A) On-demand music streaming services in place of live AM/FM radio broadcasts from commercial radio stations over the Internet

[1] I would listen to on-demand music streaming service(s) through the paid subscription(s) I already have (*e.g.*, Apple Music, Spotify Premium, Google Play Music).

[2] I would purchase new paid subscription(s) to on-demand music streaming service(s) that I don't currently subscribe to (*e.g.*, an individual subscription to Apple Music, Spotify Premium, or Google Play Music at \$9.99 per month or \$119.88 per year).

[3] I would listen to on-demand music streaming service(s) that have ads and that I do not need to pay for (*e.g.*, ad-supported Spotify).

[4] I would listen to music on video site(s) that have ads and that I do not need to pay for (*e.g.*, ad-supported YouTube).

B) Not-on-demand music streaming services in place of live AM/FM radio broadcasts from commercial radio stations over the Internet

[5] I would listen to not-on-demand music streaming service(s) through the paid subscription(s) I already have (*e.g.*, Pandora Plus).

[6] I would purchase new paid subscription(s) to not-on-demand music streaming service(s) that I don't currently subscribe to (*e.g.*, an individual subscription to Pandora Plus at \$4.99 per month or \$59.88 per year).

[7] I would listen to not-on-demand music streaming service(s) that have ads and that I do not need to pay for (*e.g.*, ad-supported Pandora).

C) Satellite radio (Sirius XM) in place of live AM/FM radio broadcasts from commercial radio stations over the Internet

³⁰⁶ The question presentation included informing respondents that they may click a link to review the definitions for “Live AM/FM radio broadcasts through a radio” “Live AM/FM radio broadcasts over the Internet” “Satellite radio (SiriusXM)” “On-demand music streaming services” “Not-on-demand music streaming services”. *See, e.g.* Hauser WDT app. D-11.

[8] I would listen to satellite radio through the paid subscription I already have (Sirius XM).

[9] I would purchase a new paid subscription to satellite radio that I don't currently subscribe to (*e.g.*, a Sirius XM subscription at \$10.99 per month or \$131.88 per year for ad-free music, \$15.99 per month or \$191.88 per year for ad-free music, news, traffic, weather, and other content).

D) Other ways of listening to live AM/FM radio broadcasts in place of such broadcasts from commercial radio stations over the Internet

[10] I would listen to live AM/FM radio broadcasts from commercial radio stations through a radio.

[11] I would listen to live AM/FM radio broadcasts from not-for-profit radio stations (*e.g.*, NPR, college radio stations) through a radio.

[12] I would listen to live AM/FM radio broadcasts from not-for-profit radio stations (*e.g.*, NPR, college radio stations) over the Internet.

E) Owned or purchased audio in place of live AM/FM radio broadcasts from commercial radio stations over the Internet

[13] I would listen to digital music files or CDs that I already purchased.

[14] I would purchase and listen to digital music files or CDs that I don't currently own.

[15] I would listen to music obtained through peer-to-peer file sharing or free download sites.

[16] I would listen to non-music digital content that I already purchased or downloaded (*e.g.*, podcasts, audiobooks).

[17] I would purchase or download and listen to non-music digital content that I don't currently own (*e.g.*, podcasts, audiobooks).

F) Television and video options in place of live AM/FM radio broadcasts from commercial radio stations over the Internet

[18] I would watch video content that I already purchased, subscribe to, or have access to (*e.g.*, movies, cable television, Hulu, Netflix).

[19] I would purchase or subscribe to video content that I don't currently own or subscribe to (*e.g.*, movies, cable television, a Hulu subscription at \$5.99 per month or \$71.88 per year, a Netflix subscription at \$8.99 per month or \$107.88 per year).

[20] I would listen to music channels through my existing cable or satellite television subscription (*e.g.*, Music Choice).

G) Print options in place of live AM/FM radio broadcasts from commercial radio stations over the Internet

[21] I would read print or online content that I already purchased, subscribe to, or have access to (*e.g.*, books, newspapers, magazines).

[22] I would purchase or subscribe to print or online content that I don't currently own or subscribe to (*e.g.*, books, newspapers, magazines).

Others

[23] Other [PIPE IN RESPONSE TEXT FROM Q4]

[24] Don't know / Unsure

Hauser WDT app. D-15-17

Appendix Q, displays a table of the results to Q4 regarding *consider* options, and is reproduced below.

Activities to Which Respondents Would Switch If Internet Simulcasts of Terrestrial Commercial Radio Were Unavailable for Five Years Q4

Response Options ^[1]	Would consider	Would not consider	Don't know/Unsure
A) On-demand music streaming services in place of live AM/FM radio broadcasts from commercial radio stations over the Internet			
1. I would listen to on-demand music streaming service(s) through the paid subscription(s) I already have (e.g., Apple Music, Spotify Premium, Google Play Music).	295 (58.9%)	141 (28.1%)	65 (13.0%)
2. I would purchase new paid subscription(s) to on-demand music streaming service(s) that I don't currently subscribe to (e.g., an individual subscription to Apple Music, Spotify Premium, or Google Play Music at \$9.99 per month or \$119.88 per year).	150 (29.9%)	256 (51.1%)	95 (19.0%)
3. I would listen to on-demand music streaming service(s) that have ads and that I do not need to pay for (e.g., ad-supported Spotify).	386 (77.0%)	72 (14.4%)	43 (8.6%)
4. I would listen to music on video site(s) that have ads and that I do not need to pay for (e.g., ad-supported YouTube).	381 (76.0%)	78 (15.6%)	42 (8.4%)
B) Not-on-demand music streaming services in place of live AM/FM radio broadcasts from commercial radio stations over the Internet			
5. I would listen to not-on-demand music streaming service(s) through the paid subscription(s) I already have (e.g., Pandora Plus).	229 (45.7%)	199 (39.7%)	73 (14.6%)
6. I would purchase new paid subscription(s) to not-on-demand music streaming service(s) that I don't currently subscribe to (e.g., an individual subscription to Pandora Plus at \$4.99 per month or \$59.88 per year).	148 (29.5%)	275 (54.9%)	78 (15.6%)
7. I would listen to not-on-demand music streaming service(s) that have ads and that I do not need to pay for (e.g., ad-supported Pandora).	350 (69.9%)	106 (21.2%)	45 (9.0%)
C) Satellite radio (SiriusXM) in place of live AM/FM radio broadcasts from commercial radio stations over the Internet			
8. I would listen to satellite radio through the paid subscription I already have (SiriusXM).	210 (41.9%)	221 (44.1%)	70 (14.0%)
9. I would purchase a new paid subscription to satellite radio that I don't currently subscribe to (e.g., a SiriusXM subscription at \$10.99 per month or \$131.88 per year for ad-free music, \$15.99 per month or \$191.88 per year for ad-free music, news, traffic, weather, and other content).	114 (22.8%)	297 (59.3%)	90 (18.0%)
D) Other ways of listening to live AM/FM radio broadcasts in place of such broadcasts from commercial radio stations over the Internet			
10. I would listen to live AM/FM radio broadcasts from commercial radio stations through a radio.	454 (90.6%)	26 (5.2%)	21 (4.2%)
11. I would listen to live AM/FM radio broadcasts from not-for-profit radio stations (e.g., NPR, college radio stations) through a radio.	359 (71.7%)	82 (16.4%)	60 (12.0%)
12. I would listen to live AM/FM radio broadcasts from not-for-profit radio stations (e.g., NPR, college radio stations) over the Internet.	362 (72.3%)	85 (17.0%)	54 (10.8%)

**Activities to Which Respondents Would Switch If Internet Simulcasts of
Terrestrial Commercial Radio Were Unavailable for Five Years**
Q4

Response Options ^[1]	Would consider	Would not consider	Don't know/Unsure
E) Owned or purchased audio in place of live AM/FM radio broadcasts from commercial radio stations over the Internet			
13. I would listen to digital music files or CDs that I already purchased.	397 (79.2%)	77 (15.4%)	27 (5.4%)
14. I would purchase and listen to digital music files or CDs that I don't currently own.	260 (51.9%)	167 (33.3%)	74 (14.8%)
15. I would listen to music obtained through peer-to-peer file sharing or free download sites.	190 (37.9%)	217 (43.3%)	94 (18.8%)
16. I would listen to non-music digital content that I already purchased or downloaded (e.g., podcasts, audiobooks).	299 (59.7%)	145 (28.9%)	57 (11.4%)
17. I would purchase or download and listen to non-music digital content that I don't currently own (e.g., podcasts, audiobooks).	240 (47.9%)	181 (36.1%)	80 (16.0%)
F) Television and video options in place of live AM/FM radio broadcasts from commercial radio stations over the Internet			
18. I would watch video content that I already purchased, subscribe to, or have access to (e.g., movies, cable television, Hulu, Netflix).	420 (83.8%)	61 (12.2%)	20 (4.0%)
19. I would purchase or subscribe to video content that I don't currently own or subscribe to (e.g., movies, cable television, a Hulu subscription at \$5.99 per month or \$71.88 per year, a Netflix subscription at \$8.99 per month or \$107.88 per year).	223 (44.5%)	211 (42.1%)	67 (13.4%)
20. I would listen to music channels through my existing cable or satellite television subscription (e.g., Music Choice).	315 (62.9%)	119 (23.8%)	67 (13.4%)
G) Print options in place of live AM/FM radio broadcasts from commercial radio stations over the Internet			
21. I would read print or online content that I already purchased, subscribe to, or have access to (e.g., books, newspapers, magazines).	312 (62.3%)	127 (25.3%)	62 (12.4%)
22. I would purchase or subscribe to print or online content that I don't currently own or subscribe to (e.g., books, newspapers, magazines).	213 (42.5%)	205 (40.9%)	83 (16.6%)
23. Other ^[2]	34 (100.0%)	—	—
Average Number of Selections per Respondent	12.6	6.7	2.7

Source: Simulcast Switching Survey (N=501)

Note:

[1] Q4: "Now suppose that live AM/FM radio broadcasts from commercial radio stations over the Internet were not available for the next five years. Assume that everything else would be available for the next five years as it is now. Which of the following, if anything, would you consider doing in place of listening to such broadcasts over the Internet during the next five years? The prices below are examples and do not include promotional discounts, taxes, or fees."

[2] The open-ended responses to Q4 include 15 respondents who indicated that there was nothing else they would consider by writing "nothing," "none," "all of my options were covered above," or something similar.

Hauser WDT app. Q.

Appendix R, displays a table of the results to Q5 regarding which option they *would choose*, and is reproduced below.

Activities to Which Respondents Would Switch If Internet Simulcasts of Terrestrial Commercial Radio Were Unavailable for Five Years

Q5

Response Options ^[1]	Count	Percentage	95% Confidence Interval ^[2]
A) On-demand music streaming services in place of live AM/FM radio broadcasts from commercial radio stations over the Internet	92	18.4%	[15.0%, 21.8%]
1. I would listen to on-demand music streaming service(s) through the paid subscription(s) I already have (e.g., Apple Music, Spotify Premium, Google Play Music).	37	7.4%	[5.1%, 9.7%]
2. I would purchase new paid subscription(s) to on-demand music streaming service(s) that I don't currently subscribe to (e.g., an individual subscription to Apple Music, Spotify Premium, or Google Play Music at \$9.99 per month or \$119.88 per year).	7	1.4%	[0.4%, 2.4%]
3. I would listen to on-demand music streaming service(s) that have ads and that I do not need to pay for (e.g., ad-supported Spotify).	25	5.0%	[3.1%, 6.9%]
4. I would listen to music on video site(s) that have ads and that I do not need to pay for (e.g., ad-supported YouTube).	23	4.6%	[2.8%, 6.4%]
B) Not-on-demand music streaming services in place of live AM/FM radio broadcasts from commercial radio stations over the Internet	56	11.2%	[8.4%, 13.9%]
5. I would listen to not-on-demand music streaming service(s) through the paid subscription(s) I already have (e.g., Pandora Plus).	8	1.6%	[0.5%, 2.7%]
6. I would purchase new paid subscription(s) to not-on-demand music streaming service(s) that I don't currently subscribe to (e.g., an individual subscription to Pandora Plus at \$4.99 per month or \$59.88 per year).	14	2.8%	[1.3%, 4.2%]
7. I would listen to not-on-demand music streaming service(s) that have ads and that I do not need to pay for (e.g., ad-supported Pandora).	34	6.8%	[4.6%, 9.0%]
C) Satellite radio (SiriusXM) in place of live AM/FM radio broadcasts from commercial radio stations over the Internet	42	8.4%	[5.9%, 10.8%]
8. I would listen to satellite radio through the paid subscription I already have (SiriusXM).	26	5.2%	[3.2%, 7.1%]
9. I would purchase a new paid subscription to satellite radio that I don't currently subscribe to (e.g., a SiriusXM subscription at \$10.99 per month or \$131.88 per year for ad-free music, \$15.99 per month or \$191.88 per year for ad-free music, news, traffic, weather, and other content).	16	3.2%	[1.6%, 4.7%]
D) Other ways of listening to live AM/FM radio broadcasts in place of such broadcasts from commercial radio stations over the Internet	161	32.1%	[28.0%, 36.2%]
10. I would listen to live AM/FM radio broadcasts from commercial radio stations through a radio.	127	25.3%	[21.5%, 29.2%]
11. I would listen to live AM/FM radio broadcasts from not-for-profit radio stations (e.g., NPR, college radio stations) through a radio.	18	3.6%	[2.0%, 5.2%]
12. I would listen to live AM/FM radio broadcasts from not-for-profit radio stations (e.g., NPR, college radio stations) over the Internet.	16	3.2%	[1.6%, 4.7%]

Activities to Which Respondents Would Switch If Internet Simulcasts of Terrestrial Commercial Radio Were Unavailable for Five Years

Q5

Response Options ^[1]	Count	Percentage	95% Confidence Interval ^[2]
E) Owned or purchased audio in place of live AM/FM radio broadcasts from commercial radio stations over the Internet	56	11.2%	[8.4%, 13.9%]
13. I would listen to digital music files or CDs that I already purchased.	30	6.0%	[3.9%, 8.1%]
14. I would purchase and listen to digital music files or CDs that I don't currently own.	9	1.8%	[0.6%, 3.0%]
15. I would listen to music obtained through peer-to-peer file sharing or free download sites.	3	0.6%	[0.0%, 1.3%]
16. I would listen to non-music digital content that I already purchased or downloaded (e.g., podcasts, audiobooks).	8	1.6%	[0.5%, 2.7%]
17. I would purchase or download and listen to non-music digital content that I don't currently own (e.g., podcasts, audiobooks).	6	1.2%	[0.2%, 2.2%]
F) Television and video options in place of live AM/FM radio broadcasts from commercial radio stations over the Internet	59	11.8%	[8.9%, 14.6%]
18. I would watch video content that I already purchased, subscribe to, or have access to (e.g., movies, cable television, Hulu, Netflix).	37	7.4%	[5.1%, 9.7%]
19. I would purchase or subscribe to video content that I don't currently own or subscribe to (e.g., movies, cable television, a Hulu subscription at \$5.99 per month or \$71.88 per year, a Netflix subscription at \$8.99 per month or \$107.88 per year).	12	2.4%	[1.1%, 3.7%]
20. I would listen to music channels through my existing cable or satellite television subscription (e.g., Music Choice).	10	2.0%	[0.8%, 3.2%]
G) Print options in place of live AM/FM radio broadcasts from commercial radio stations over the Internet	15	3.0%	[1.5%, 4.5%]
21. I would read print or online content that I already purchased, subscribe to, or have access to (e.g., books, newspapers, magazines).	10	2.0%	[0.8%, 3.2%]
22. I would purchase or subscribe to print or online content that I don't currently own or subscribe to (e.g., books, newspapers, magazines).	5	1.0%	[0.1%, 1.9%]

Activities to Which Respondents Would Switch If Internet Simulcasts of Terrestrial Commercial Radio Were Unavailable for Five Years

Q5

Response Options ^[1]	Count	Percentage	95% Confidence Interval ^[2]
H) Others	17	3.4%	[1.8%, 5.0%]
23. Other ^[3]	3	0.6%	[0.0%, 1.3%]
24. Don't know / Unsure	14	2.8%	[1.3%, 4.2%]
I) Blank responses^[4]	3	0.6%	[0.0%, 1.3%]

Source: Simulcast Switching Survey (N=501)

Note:

[1] Q5: "Continue to suppose that live AM/FM radio broadcasts from commercial radio stations over the Internet were not available for the next five years. Assume that everything else would be available for the next five years as it is now. Now think about the most recent time you listened to live AM/FM radio broadcasts from commercial radio stations over the Internet. Please consider situations similar to that time and the content you listened to at that time. Which one of the following would you do in place of listening to such broadcasts over the Internet in similar situations during the next five years? The prices below are examples and do not include promotional discounts, taxes, or fees."

[2] The lower bound of the confidence interval is set to zero when the 95% symmetric confidence interval would otherwise include values smaller than zero.

[3] Three respondents selected their self-entered responses from Q4 in Q5. Those responses were: "nothing," "listening to amazon music," and "listening to radio with ads."

[4] Three respondents did not select "Would consider" for any options in Q4, thus were not directed to Q5.

Professor Hauser developed a table to summarize the alternatives that were selected by more than 3.0 percent of survey respondents, which is reproduced below.

Table 3: Activities to Which More Than Three Percent of Respondents Would Switch If Internet Simulcasts of Terrestrial Commercial Radio Were Unavailable for Five Years

Response Options	Count	Percentage	95% Confidence Interval
I would listen to live AM/FM radio broadcasts from commercial radio stations through a radio.	127	25.3%	[21.5%, 29.2%]
I would listen to on-demand music streaming service(s) through the paid subscription(s) I already have (e.g., Apple Music, Spotify Premium, Google Play Music).	37	7.4%	[5.1%, 9.7%]
I would watch video content that I already purchased, subscribe to, or have access to (e.g., movies, cable television, Hulu, Netflix).	37	7.4%	[5.1%, 9.7%]
I would listen to not-on-demand music streaming service(s) that have ads and that I do not need to pay for (e.g., ad-supported Pandora).	34	6.8%	[4.6%, 9.0%]
I would listen to digital music files or CDs that I already purchased.	30	6.0%	[3.9%, 8.1%]
I would listen to satellite radio through the paid subscription I already have (SiriusXM).	26	5.2%	[3.2%, 7.1%]
I would listen to on-demand music streaming service(s) that have ads and that I do not need to pay for (e.g., ad-supported Spotify).	25	5.0%	[3.1%, 6.9%]
I would listen to music on video site(s) that have ads and that I do not need to pay for (e.g., ad-supported YouTube).	23	4.6%	[2.8%, 6.4%]
I would listen to live AM/FM radio broadcasts from not-for-profit radio stations (e.g., NPR, college radio stations) through a radio.	18	3.6%	[2.0%, 5.2%]
I would purchase a new paid subscription to satellite radio that I don't currently subscribe to (e.g., a SiriusXM subscription at \$10.99 per month or \$131.88 per year for ad-free music, \$15.99 per month or \$191.88 per year for ad-free music, news, traffic, weather, and other content).	16	3.2%	[1.6%, 4.7%]
I would listen to live AM/FM radio broadcasts from not-for-profit radio stations (e.g., NPR, college radio stations) over the Internet.	16	3.2%	[1.6%, 4.7%]

Source: Simulcast Switching Survey (N=501), Appendix R.

Hauser WDT ¶¶ 108, table 3.

As reflected in the table, “I would listen to live AM/FM radio broadcasts from commercial radio stations through a radio” was selected by 127 respondents (25.3 percent), and was the most commonly selected alternative. Other commonly-selected alternatives included “I would listen to on-demand music streaming service(s) through the paid subscription(s) I already have (e.g., Apple Music, Spotify Premium, Google Play Music),” which was selected by 37 respondents (7.4 percent), and “I would watch video content that I already purchased, subscribe to, or have access to (e.g., movies, cable television, Hulu, Netflix),” which was selected by 37 respondents (7.4 percent). Fourteen respondents (2.8 percent) selected “don’t know/unsure” in response to this question.

Hauser WDT ¶¶ 109.

Professor Hauser weighted the results of Q5 by the total number of hours each respondent reported listening to Internet simulcasts of terrestrial commercial radio in Q1 in to evaluate whether the alternatives respondents consider as substitutes for Internet simulcasts of terrestrial radio varied based on the total amount of time respondents spend listening to such simulcasts. He explained that if a respondent listened to only one hour of such simulcasts over the prior three days, his or her response to Q5 would count as one, while if a respondent listened to four hours of such simulcasts over the prior three days, his or her response to Q5 would count as four. Hauser WDT ¶¶ 110.

Appendix S, displays a table of the weighted results to Q5, and is reproduced below.

**Activities to Which Respondents Would Switch If Internet Simulcasts of
Terrestrial Commercial Radio Were Unavailable for Five Years**
Weighted by Hours Listened
Q5

Response Options ^[1]	Percentage Weighted by Hours Listened ^{[2][3]}	95% Confidence Interval ^[4]
A) On-demand music streaming services in place of live AM/FM radio broadcasts from commercial radio stations over the Internet	17.2%	[13.8%, 20.5%]
1. I would listen to on-demand music streaming service(s) through the paid subscription(s) I already have (e.g., Apple Music, Spotify Premium, Google Play Music).	7.5%	[5.2%, 9.9%]
2. I would purchase new paid subscription(s) to on-demand music streaming service(s) that I don't currently subscribe to (e.g., an individual subscription to Apple Music, Spotify Premium, or Google Play Music at \$9.99 per month or \$119.88 per year).	1.6%	[0.5%, 2.7%]
3. I would listen to on-demand music streaming service(s) that have ads and that I do not need to pay for (e.g., ad-supported Spotify).	4.7%	[2.8%, 6.6%]
4. I would listen to music on video site(s) that have ads and that I do not need to pay for (e.g., ad-supported YouTube).	3.3%	[1.7%, 4.9%]
B) Not-on-demand music streaming services in place of live AM/FM radio broadcasts from commercial radio stations over the Internet	14.0%	[11.0%, 17.1%]
5. I would listen to not-on-demand music streaming service(s) through the paid subscription(s) I already have (e.g., Pandora Plus).	2.8%	[1.3%, 4.2%]
6. I would purchase new paid subscription(s) to not-on-demand music streaming service(s) that I don't currently subscribe to (e.g., an individual subscription to Pandora Plus at \$4.99 per month or \$59.88 per year).	2.7%	[1.2%, 4.1%]
7. I would listen to not-on-demand music streaming service(s) that have ads and that I do not need to pay for (e.g., ad-supported Pandora).	8.6%	[6.1%, 11.1%]
C) Satellite radio (SiriusXM) in place of live AM/FM radio broadcasts from commercial radio stations over the Internet	6.8%	[4.5%, 9.0%]
8. I would listen to satellite radio through the paid subscription I already have (SiriusXM).	4.3%	[2.5%, 6.1%]
9. I would purchase a new paid subscription to satellite radio that I don't currently subscribe to (e.g., a SiriusXM subscription at \$10.99 per month or \$131.88 per year for ad-free music, \$15.99 per month or \$191.88 per year for ad-free music, news, traffic, weather, and other content).	2.4%	[1.1%, 3.8%]
D) Other ways of listening to live AM/FM radio broadcasts in place of such broadcasts from commercial radio stations over the Internet	31.2%	[27.1%, 35.3%]
10. I would listen to live AM/FM radio broadcasts from commercial radio stations through a radio.	24.8%	[21.0%, 28.7%]
11. I would listen to live AM/FM radio broadcasts from not-for-profit radio stations (e.g., NPR, college radio stations) through a radio.	2.9%	[1.4%, 4.5%]
12. I would listen to live AM/FM radio broadcasts from not-for-profit radio stations (e.g., NPR, college radio stations) over the Internet.	3.4%	[1.8%, 5.0%]

**Activities to Which Respondents Would Switch If Internet Simulcasts of
Terrestrial Commercial Radio Were Unavailable for Five Years**
Weighted by Hours Listened
Q5

Response Options ^[1]	Percentage Weighted by Hours Listened ^{[2][3]}	95% Confidence Interval ^[4]
E) Owned or purchased audio in place of live AM/FM radio broadcasts from commercial radio stations over the Internet	11.3%	[8.5%, 14.1%]
13. I would listen to digital music files or CDs that I already purchased.	6.2%	[4.1%, 8.4%]
14. I would purchase and listen to digital music files or CDs that I don't currently own.	1.7%	[0.5%, 2.8%]
15. I would listen to music obtained through peer-to-peer file sharing or free download sites.	0.5%	[0.0%, 1.1%]
16. I would listen to non-music digital content that I already purchased or downloaded (e.g., podcasts, audiobooks).	1.3%	[0.3%, 2.3%]
17. I would purchase or download and listen to non-music digital content that I don't currently own (e.g., podcasts, audiobooks).	1.6%	[0.5%, 2.7%]
F) Television and video options in place of live AM/FM radio broadcasts from commercial radio stations over the Internet	11.3%	[8.5%, 14.1%]
18. I would watch video content that I already purchased, subscribe to, or have access to (e.g., movies, cable television, Hulu, Netflix).	8.0%	[5.6%, 10.4%]
19. I would purchase or subscribe to video content that I don't currently own or subscribe to (e.g., movies, cable television, a Hulu subscription at \$5.99 per month or \$71.88 per year, a Netflix subscription at \$8.99 per month or \$107.88 per year).	1.8%	[0.6%, 3.0%]
20. I would listen to music channels through my existing cable or satellite television subscription (e.g., Music Choice).	1.6%	[0.5%, 2.7%]
G) Print options in place of live AM/FM radio broadcasts from commercial radio stations over the Internet	3.0%	[1.5%, 4.5%]
21. I would read print or online content that I already purchased, subscribe to, or have access to (e.g., books, newspapers, magazines).	1.4%	[0.4%, 2.5%]
22. I would purchase or subscribe to print or online content that I don't currently own or subscribe to (e.g., books, newspapers, magazines).	1.6%	[0.5%, 2.7%]

**Activities to Which Respondents Would Switch If Internet Simulcasts of
Terrestrial Commercial Radio Were Unavailable for Five Years**
Weighted by Hours Listened
Q5

Response Options ^[1]	Percentage Weighted by Hours Listened ^{[2][3]}	95% Confidence Interval ^[4]
H) Others	4.8%	[2.9%, 6.7%]
23. Other	0.8%	[0.0%, 1.6%]
24. Don't know / Unsure	4.0%	[2.3%, 5.7%]
I) Blank responses^[5]	0.5%	[0.0%, 1.1%]

Source: Simulcast Switching Survey (N=490)

Note:

- [1] Q5: "Continue to suppose that live AM/FM radio broadcasts from commercial radio stations over the Internet were not available for the next five years. Assume that everything else would be available for the next five years as it is now. Now think about the most recent time you listened to live AM/FM radio broadcasts from commercial radio stations over the Internet. Please consider situations similar to that time and the content you listened to at that time. Which one of the following would you do in place of listening to such broadcasts over the Internet in similar situations during the next five years? The prices below are examples and do not include promotional discounts, taxes, or fees."
- [2] This tabulation excludes respondents who answered "don't know/unsure" in Q1a. Q1a: "Thinking about the last three days, approximately how many total hours did you spend listening to live AM/FM radio broadcasts from commercial radio stations over the Internet?"
- [3] The percentage of respondents making each selection from Q5 is weighted by hours listened reported in Q1a.
- [4] The lower bound of the confidence interval is set to zero when the 95% symmetric confidence interval would otherwise include values smaller than zero.
- [5] Three respondents did not select "Would consider" for any options in Q4, thus were not directed to Q5.

b. Criticisms of the Hauser Survey

SoundExchange offers several critiques of the Hauser surveys, including those noted below. SX PFFCL ¶¶ 1208-1269.

i. Hypothetical Scenario

SoundExchange notes that Professor Hauser's hypothetical scenario requires respondents to predict what they would do if "live AM/FM radio broadcasts from commercial radio stations over the Internet were not available for the next five years." Hauser WDT, app. D at D-11. It maintains that the hypothetical, which does not mention music content, may cause respondents to answer the replacement questions in terms of how they would replace non-music content, rather than how they would replace music content. Zauberman WRT ¶ 64. SoundExchange also argues that the long, five year, period toward which respondents are directed to forecast their behavior can be cognitively taxing and confusing for individuals. Zauberman WDT ¶ 62; *see also* Simonson WRT ¶¶ 111-112. SoundExchange notes expert testimony from Professor Zauberman who maintained that the ambiguity of Professor Hauser's hypothetical does not adequately follow best practice, which dictates that hypotheticals be posed in a way that ensures the maximum relatability so that respondents are not confused about the scenario they are asked to consider. Zauberman WRT ¶ 65, *See, e.g.,* Floyd Jackson Fowler, Jr., *How Unclear Terms Affect Survey Data*, 56 PUB. OPINION Q. 218-231 (1992); *see also*, Norbert Schwartz & Daphna Oyserman, *Asking Questions About Behavior: Cognition, Communication, and Questionnaire Construction*, 22 AM. J. EVALUATION, no.2, 127-160 (2001).

ii. Response Options

SoundExchange argues that Professor Hauser did not customize his list of Q4 replacement options to match respondents' individual circumstances. Instead, SoundExchange notes, all respondents received the same list of replacement options,

regardless of whether or not all of these options were applicable to them. Professor Zauberman noted that eight of the 22 specific options that Professor Hauser poses for all respondents to consider in Q4 refer to services or content that they are told they already own, have access to, or have purchased, regardless of whether that is true or not.

Professor Zauberman asserted that providing such response options to respondents, which do not apply to them, is confusing. Zauberman WRT ¶ 66-67. Professor Zauberman added that providing respondents with options regardless of the service/content they already own, have access to, or have purchased is poor survey design. Zauberman WRT ¶ 66-67, *See, e.g. Questionnaire Design*, PEW RES. CENTER, <https://www.pewresearch.org/methods/u-s-survey-research/questionnaire-design/> (last visited Jan. 8, 2020); *see also*, Don A. Dillman et al., *The Fundamentals of Writing Questions*, in *INTERNET, PHONE, MAIL, AND MIXED-MODE SURVEYS: THE TAILORED DESIGN METHOD* 94, 114-116 (4th ed. 2014),

Professor Zauberman explained the potentially troubling impact of this question design by considering how a respondent who does not already subscribe to a paid on-demand streaming service may react to option 1, in Q4 (“I would listen to on-demand music streaming service(s) through the paid subscription(s) I already have”), given the choices: “Would consider” “Would not consider” and “Don’t know/Unsure?”. Professor Zauberman opined that, in such a scenario, none of the available options makes sense. He maintained that the only logical answer regarding a service that the respondent does not already have would be “N/A” or “I do not have such a subscription” and these choices were not present in the survey. Instead, he suggested that respondents may be forced to answer as if they have the service. Zauberman WRT ¶ 68.

Professor Zauberman identified another alleged flaw in that Professor Hauser’s response options are designed in a way that confuses respondents. He argued that the Hauser survey presented respondents with too many response options, and cited

scholarship indicating that such choice options may causes cognitive overload and thus unreliable responses. Zauberman WRT ¶ 68; *see, e.g.*, Sheena S. Iyengar & Mark R. Lepper, *When Choice is Demotivating: Can One Desire Too Much of a Good Thing?*, 79 J. PERSONALITY & SOC. PSYCHOL., no.6, 995-1006 (2000); Elena Reutskaja et al., *Choice Overload Reduces Neural Signatures of Choice Set Value in Dorsal Striatum and Anterior Cingulate Cortex*, 2 NATURE HUM. BEHAV., 925-935 (2018).

Professor Zauberman explained that Q4 presented respondents with a list of 22 specific response options, plus an open response “Other.” And, in Q5, respondents are presented with a list of 22 options, plus a “Don’t know/Unsure” option, *and* a potential “Other” option, depending on their answers Q4. Professor Zauberman offered his view that this is indicative of choice overload. Zauberman WRT ¶ 70; *see, e.g.*, Alexander Chernev et al., *Choice overload: A conceptual review and meta-analysis*, 25 J. CONSUMER PSYCHOL., no.2, 333-358 (2015).

Professor Zauberman argued that Professor Hauser’s survey design nudges respondents toward choosing free music services and other non-royalty-bearing options, over paid music options, and nudges them to select low or non-royalty-bearing switching options. He asserted that 15 out of the 22 specific options in Q4 and Q5 lead to zero new royalties for record labels, and that this is disproportionately biased towards zero royalties options. Zauberman WRT ¶ 71. Professor Zauberman also opined that the options may confuse respondents by mixing types of content (*e.g.* “non-music digital content” or “music on video sites”). He added that providing options that are not mutually exclusive (*e.g.* “streaming service(s)” or “AM/FM radio broadcasts”) is troubling. Zauberman WRT ¶ 71. Professor Zauberman maintained that Professor Hauser’s descriptions within the response options suffer from inconsistent framing and definitions, which he found to privilege free options. In Professor Zauberman’s view the survey fails to emphasize “free vs. paid” music listening options in a consistent manner in Q4 and Q5, namely that the

non-monetary cost of the free options is less clear or emphasized than the clear indication of the “paid” characteristics. Professor Zauberman pointed out that in Option 3, Professor Hauser chose to use the phrase “have ads and that I do not need to pay for” rather than simply saying “free” to contrast “paid” in Option 2. In Professor Zauberman’s view, this wording in Option 3, rather than simply saying “free on-demand music streaming service(s),” makes the cost (or lack thereof) of the option less salient than the cost (or lack thereof) of its paid counterpart. Zauberman WRT ¶ 71.

Professor Zauberman also found fault with the Hauser survey for excluding options to which respondents might reasonably switch. He noted that the survey does not, for example, describe or offer listening to Sirius XM online as a response option. He argued that if legitimate options had been offered as potential choices, respondents might have been more likely to select other existing paid subscriptions. And, he added, limiting the number of royalty-bearing response options available is likely to depress the number of respondents who select royalty-bearing options. Zauberman WRT ¶ 71.

Professor Zauberman concluded that the cumulative effect of the criticized survey response options is to privilege certain response options (*e.g.*, AM/FM radio) over others. He maintained that Professor Hauser’s survey failed to ensure that the survey hypothetical was as clear and well-defined as possible. Zauberman WRT ¶ 71.

Professor Simonson also criticized the Hauser survey response options, characterizing the survey as burying music within a wide range of content alternatives, such as traffic, religion, and sports. He pointed out that in the Hauser survey Q2 and Q3, “music” represented just one out of eight response options, and that all types and genres of music were reduced to just one item, listed alongside a wide range of equally prominent, unrelated categories. Simonson WRT ¶ 102-105.

Mr. Simonson asserted that respondents tend to choose among the options presented to them, citing scholarship on that conclusion:

[R]espondents tend to confine their answers to the choices offered, even if the researcher does not wish them to do so (Bishop *et al.* 1988, Presser 1990). That is, people generally ignore the opportunity to volunteer a response and simply select among those listed, even if the best answer is not included.

Zauberman WRT ¶ 106 (citing Jon A. Krosnick, *Survey Research*, 50 ANN. REV. PSYCHOL. 537, 544 (1999)). Mr. Simonson argued that in the context of a proceeding about music, including numerous non-music response options biases survey results, including through diversification bias, order effects, and demand artifacts. Simonson WRT ¶ 106 (citing Fritz Strack, “*Order Effects*” in *Survey Research: Activation and Information Functions of Preceding Questions*, in CONTEXT EFFECTS IN SOCIAL AND PSYCHOLOGICAL RESEARCH 23-34 (Norbert Schwarz & Seymour Sudman eds., 1992), https://doi.org/10.1007/978-1-4612-2848-6_3).

He referred to additional research, indicating that the mere fact that respondents are presented simultaneously with multiple options causes them to spread their choices among the options instead of choosing only the option they like most. He argued that a survey designer can decrease the percentage of respondents who indicate they will switch from one music service to another by presenting respondents with a wide range of options, and that the Hauser Survey does that by leading respondents to consider a wide set of switching options, including options that are unrelated to music. Simonson WRT ¶¶ 106, 67-74 (citing Itamar Simonson, *The Effect of Purchase Quantity and Timing on Variety Seeking Behavior*, 27 J. MARKETING RES. 150 (1990); Daniel Read & George Loewenstein, *Diversification Bias: Explaining the Discrepancy in Variety Seeking Between Combined and Separated Choices*, 1 J. EXPERIMENTAL PSYCHOL.: APPLIED 34 (1995); and Schlomo Benartzi & Richard H. Thaler, *Naïve Diversification Strategies in Defined Contribution Saving Plans*, 91 AM. ECON. REV. 79 (2001); and Craig R. Fox, David Bardolet & Daniel Lieb, *How Subjective Grouping of Options Influences Choice and Allocation: Diversification Bias and the Phenomenon of Partition Dependence*, 134

J. EXPERIMENTAL PSYCHOL.: GEN. 538 (2005); Craig R. Fox, David Bardolet & Daniel Lieb, *Partition Dependence in Decision Analysis, Resource Allocation, and Consumer Choice*, 3 EXPERIMENTAL BUS. RES. 229 (2005)). Professor Simonson concluded that by offering “irrelevant options” the Hauser survey misrepresents people’s real-world experience, in which other content does not generally satisfy a desire for music, and the result is likely to lower the likelihood that respondents choose music options. Simonson WRT ¶ 107.

iii. Two-Stage Decision Making Process

SoundExchange argues that Professor Hauser’s two-stage decision-making structure compounds the alleged errors identified above and further depresses diversion to royalty-bearing options.

SoundExchange notes that the Hauser survey first asks respondents, in Q4, to identify from a list of 22 identified music and non-music options all of the alternatives they would “consider” switching to in place of simulcasts. Then, in Q5, the survey forces respondents to pick just one option from this consideration set that they would use if “live AM/FM radio broadcasts from commercial radio stations over the Internet were not available for the next five years.” SoundExchange alleges that it was inappropriate for Professor Hauser to present his replacement questions using this “consider-then-choose” structure. SoundExchange argues that this two-stage process, in which respondents must consider a large set of options before making a final choice, does not match the decision-making processes that consumers actually would engage in if they were replacing their simulcast listening. Zauberman WRT ¶¶ 10-14, 73; Simonson WRT ¶¶ 108-109.

SoundExchange also argues that the Hauser survey is flawed because Professor Hauser provides no justification for forcing respondents, in Q5, to choose only *one* option to replace their simulcasting over the course of the next five years. SoundExchange asserts that in the real world consumers can replace music options with multiple

substitutes, and takes issue with what it characterizes as an unrealistic notion that, for the next five years, respondents must limit themselves to only one alternative option.

Zauberman WRT ¶ 73; Simonson WRT ¶¶ 112. SoundExchange notes that Professor Hauser acknowledges that it is “not uncommon for individuals to have subscriptions to multiple services, even within the same service type” and that some listeners employ multiple services “because different services within the same service type may offer different features for listeners and different libraries of content.” Hauser WDT ¶ 85.

SoundExchange also posits that the requirement that respondents to the Hauser survey choose only one of the offered currently available options stands in contrast to the reality of a fast changing market. SX PFFCL ¶ 1245 (citing Tucker WDT ¶¶ 10-15).

SoundExchange observes that Professor Hauser attempts to ameliorate this concern by focusing respondents on the last three days, and asking what one alternative they would choose in situations similar to their most recent listening session. Hauser WDT ¶ 13 & n.8, app. D; 8/27/20 Tr. 4344 (Hauser). However, SoundExchange asserts that this approach fails because, although the survey does mention the last three days, the replacement questions themselves do not contain this language. SX PFFCL ¶ 1251 (citing Zauberman WRT ¶ 74-75 & n.92 (Professor Hauser’s “replacement question is for the next five years, not a single use”)). SoundExchange also argues that Professor Hauser’s replacement questions create a winner-take-all problem, which biases his results. It offers the example scenario in which Netflix is the primary streaming video service for consumers, but that many consumers also use Amazon Prime Video to a lesser degree. If asked to name only one streaming video service that they use, consumers would choose Netflix. SoundExchange maintains that such responses would mask the extent to which the secondary choice, Amazon Prime Video, is used. Zauberman WRT ¶ 75. Professor Zauberman testified that this type of the winner takes all structure of the

replacement questions “is highly confusing,” and “tremendously underplays [the] secondary players”. 8/27/20 Tr. 4210-11 (Zauberman).

iv. Time Estimation Question

SoundExchange argues that Professor Hauser’s time estimation question highlights the unreliability of his survey and biases the key questions that follow it. SX PFFCL ¶ 1262. It notes Professor Hauser’s finding that, on average, respondents estimated that they spent 5.3 hours listening to AM/FM radio broadcasts from commercial radio stations over the Internet in the past three days (or approximately 1.75 hours per day). SX PFFCL ¶ 1263 (citing Hauser WDT ¶ 94). SoundExchange asserts that time estimate does not at all match reality, and that this mismatch highlights a bias in Professor Hauser’s survey population. SX PFFCL ¶ 1264. It points to Professor Zauberman’s testimony that, according to *The Infinite Dial 2019*, Digital AM/FM (*i.e.*, streaming AM/FM radio) accounts for only 3% of time spent listening to music, and the average online audio listener spends approximately 16.72 hours per week (or 2.39 hours per day) listening to *all* online audio sources. Professor Zauberman noted that, by contrast, Professor Hauser’s time estimates, if accurate, would mean that AM/FM streamed over the Internet accounts for more than 70% of *all* online audio listening time, on average. Zauberman WRT ¶ 76 (citing Edison Research & Triton Digital, *The Infinite Dial 2019* at 26; and Edison Research, *Share of Ear Q2 2019* at 16). Professor Zauberman added that Professor Hauser provides no empirical evidence, such as industry data, to suggest that respondents are able to provide reliable estimates, and that available industry data calls the accuracy of the time estimates derived from Professor Hauser’s survey into question. Zauberman WRT ¶ 77. Professor Zauberman also argued that qualitative pretests in surveys cannot assure that this type of timing question is reliable or that the right timeframe is being used. Zauberman WRT ¶ 77; 8/27/20 Tr. 4181-82 (Zauberman) (a pretest is “where you test for confusion,” not an instrument for

“parameteriz[ing] your elements of your survey,” like time); *id.* at 4291-92, 4293-94 (Simonson) (same).

Professor Zauberman argued that because the timing question is the first question in the main questionnaire, it has the potential to influence responses to all subsequent questions. He cites to scholarship indicating that starting with a difficult-to-estimate question can influence the way that respondents answer the rest of the questions, especially when the rest of the survey is complex and difficult to understand. Zauberman WRT ¶ 78 (citing Shari Seidman Diamond, *Reference Guide on Survey Research*, in REFERENCE MANUAL ON SCIENTIFIC EVIDENCE 359, 395-96 (2011); Seymour Sudman & Norbert Schwartz, *Contributions of Cognitive Psychology to Advertising Research*, 29 J. ADVERTISING RES., no.3, 43-53 (1989); Jon A. Krosnick & Stanley Presser, *Question and Questionnaire Design*, in HANDBOOK OF SURVEY RESEARCH 263, 291-94 (2nd. ed. 2010)).

Professor Zauberman also faulted the Hauser surveys for not asking respondents to estimate listening time in the future. He maintained that absent responses about future use, any inferences made based on the offered results must rely on an *assumption* about the extent to which a hypothetical change in the marketplace (*i.e.*, the unavailability of AM/FM streaming) would in fact alter both the amount of time respondents spend listening to music in total, as well as for each of the options they would replace it with. Professor Zauberman argues that such an assumption would be problematic without empirical support. Zauberman WRT ¶ 79.

c. Responses to Criticism of the Hauser Survey

The NAB responded to criticism regarding the number and type of alternatives offered in the switching questions, by noting that Professor Hauser crafted the switching options based on his experience from prior rate-setting proceedings in which his surveys were accepted (including *SDARS III*, where the survey had 19 switching options),

research into the different ways respondents access different types of content, industry studies, and the feedback he received in the course of conducting qualitative interviews and pretests. 8/27/20 Tr. 4340-44 (Hauser); Hauser WDT ¶¶ 19-20, 25, 31-33. Professor Hauser testified that his pretests confirmed that respondents found the options to be comprehensive but not too numerous, and to reflect the full scope of options they would consider instead of listening to simulcasts. 8/27/20 Tr. 4340-43 (Hauser). The NAB adds that SoundExchange has advanced arguments and evidence in this proceeding to establish that a wide variety of services, including on-demand video services, broadcast television, video games, and other forms of media, are in competition with each other, and that therefore it was not unreasonable for Professor Hauser to include a variety of services as switching options in his survey. *See, e.g.*, Trial Ex. 5387 at 28; Trial Exs. 5521, 5353, 5472; Orszag WRT ¶ 46 n.96 (citing public financial documents, including iHeart 10-Ks).

The NAB addresses SoundExchange's criticism of the Hauser survey for directing respondents to choose one switching option, when consumers in the real world might replace simulcast with more than one alternative, by noting that the survey was "fielded over ten days, invitations were released at different times of the day to ensure representative by day of week." The NAB argues that this approach ensures a random draw in time from the distribution of all instances of listening to simulcast. 8/27/20 Tr. 4352-53, 4356-57 (Hauser). Professor Hauser maintained that under the approach he used, even if some respondents would listen to terrestrial radio for 60% of their time, but on-demand for the remaining 40%, and listening is reasonably randomly distributed, respondents would pick terrestrial radio 60% of the time and on-demand 40% of the time when asked about the most recent time they listened. 8/26/20 Tr. 4354 (Hauser); Hauser WDT ¶ 37.

The NAB addressed Professor Simonson's concern that the Hauser survey asked respondents to pick just one option that they would do for the next five years, by maintaining that Professor Hauser's question was never meant to say that respondents will do the same thing in every similar situation. Professor Hauser indicated that the qualitative interviews and pretests confirmed that is not how respondents interpreted the question. 8/27/20 Tr. 4355-56 (Hauser); *see also* Hauser WDT app. G at 8. He testified that because respondents were primed to think of "situations similar to" the "most recent time" they listened to simulcast, their responses reflect what they would do in a similar circumstance, not what they would do "repetitively each day over the next five years." 8/27/20 Tr. 4356-58 (Hauser).

The NAB argues that Professor Hauser's time estimation question is not unreliable and does not conflict with results in the Infinite Dial 2019 and Share of Ear surveys. It asserts that the critique is based on an "apples-to-oranges mistake." *See, e.g.,* Zauberman WRT ¶ 76. Professor Hauser posits that his survey was focused on simulcast listeners, whereas the Infinite Dial and Share of Ear targeted listeners to *all* online audio. 8/27/20 Tr. 4361 (Hauser). He points out that Professor Zauberman's comparison does not take into account respondents who listened to zero hours of simulcasts. Professor Hauser offered that "if you put those zeros in, that zero listening, my study lines up pretty well with the [I]nfinite [D]ial." *Id.* at 4361.

d. Judges' conclusions regarding the Hauser Survey

The Judges accept that there are a variety of choices to be made when designing a reliable survey. The selected design choices will often be subject to second-guessing. While the Judges are wary of unreasonably demanding ideal survey design, many critiques will inevitably merit consideration, to varying degrees.

In this instance, the Judges find that the main hypothetical scenario set forth requiring respondents to predict what they would do if live AM/FM radio broadcasts

from commercial radio stations over the Internet were not available for the next five years is reasonable. While the record reflects some reason to caution against the long, five year, prediction timeframe as potentially confusing respondents, the Judges do not find that this to be unduly concerning in this instance. However, as discussed further below, the Judges find that the critique regarding the main hypothetical scenario not honing in on music content (thus skewing the results) is worthy of concern.

The Judges find that the Hauser survey approach to the time estimation question was unduly biased toward simulcast listeners in a manner that biased the overall results. The fact that the results of the time estimate question diverge so widely from what may be considered reasonable in light of available industry data exacerbates the Judges' concerns of bias. These concerns ultimately weigh against the overall reliability of the survey.³⁰⁷

The Judges find that the "consider-then-choose" structure is an acceptable design choice in this instance. A case could be made that certain consumer choices on specific products or services are ill-suited to such a format. However, SoundExchange has not established convincingly that the design is inappropriate in this case. The decision to offer only one option is more concerning, given that it is widely accepted that consumers often choose more than one music (or non-music) option, especially over a five year period. The NAB's argument that this concern is addressed by the survey being fielded over multiple days does little to ameliorate the Judges concern that, in this particular switching survey addressing music options, limiting respondents' choice to one option may confuse respondents and bias results. The NAB's reference to qualitative interviews

³⁰⁷ The Judges are less troubled that the time estimate questions in the Hauser survey may be unduly confusing or that any confusion caused would unduly skew the overall results of the survey.

does not establish to the Judges' satisfaction that respondents understood the question clearly, or that bias is not likely present in the results.

The actual response options provided are the most troubling aspect of the survey. Based on the expert testimony of Professors Zauberman and Simonson the Judges find that the number of choices, in the format provided, can reasonably be expected to produce biased and unreliable results. Professor Hauser indicates that he crafted the switching options based on his experience from prior rate-setting proceedings in which his surveys were accepted (including *SDARS III*, where the survey had 19 switching options). However, the *SDARS III* survey was offered in a different format in which the 19 choices were set forth in two stages. Additionally, the offered choices were far more oriented toward music options, which the Judges find more appropriate in the current proceeding to set rates for transmissions of recorded music.

The Judges also note that the defined parameters of not-on-demand music streaming services are limited in a troubling—and ultimately unreasonable—fashion. As SoundExchange noted, the category excludes Sirius XM online as a response option. Additionally, the category excludes a wider array of webcast transmissions that do not vary the music played based on an individual listener's preferences, which Dr. Leonard characterizes as "internet radio." The 22 specific options in Q4 and Q5, on their face, and in reference to the definition of "Not-on-demand music streaming services" exclude "internet radio." Professor Hauser did not explain or justify these exclusions adequately.

Professor Hauser testified that his pretests confirmed that respondents found the options to be comprehensive but not too numerous, and to reflect the full scope of options they would consider instead of listening to simulcasts. But, the offered options are not comprehensive. Professor Hauser stated that he generated the options from qualitative interviews, which explored what listeners of Internet simulcasts of terrestrial commercial radio considered as substitutes for listening to Internet simulcasts. However, it is not

apparent that the pretests or interview clearly referenced the ensuing survey's hypothetical *loss* of simulcasting in the marketplace.

Professor Hauser testified that these interviewees described a number of different activities they would do if they could not listen to Internet simulcasts of terrestrial commercial radio, including listening to music through paid and ad-supported streaming services, listening to podcasts, watching television or movies, and reading news on their computers or smartphones. He indicated that the qualitative interviews revealed that respondents were not familiar with the terms "simulcast" or "simulcasting," nor were many of them familiar with the term "terrestrial radio." Respondents understood the phrase "live radio broadcasts over the Internet" to describe Internet simulcasts of terrestrial radio. He used the responses to inform the list of alternatives for Q4 of the survey. However, Professor Hauser does not adequately explain why he only offered a subset of personalized ad-supported streaming services in the alternatives for Q4.

He also states that he augmented these option choices with additional background research into the different ways in which respondents may access different types of content, including Edison Research & Triton Digital, "The Infinite Dial – The Heavy Radio Listeners Report," April 2018, available at <https://www.edisonresearch.com/heavy-radio-listeners-new-insights-from-the-infinite-dial>, p. 8; Edison Research & Triton Digital, "The Infinite Dial 2019," 2019, available at <https://www.edisonresearch.com/infinite-dial-2019/>, p. 30. However, these two pieces of industry data do not exclude "internet radio."

Another of the NAB's witnesses, Dr. Leonard, who relied on Professor Hauser's survey and testimony for purposes of his opportunity cost analysis, addresses a related issue of his own treatment of internet radio as a product category. Dr. Leonard opined that internet radio is more similar to custom radio than to simulcast. He acknowledged that internet radio stations do not vary the music played based on an individual listener's

preferences, which the Judges note is a characteristic that is shared with simulcasters. However, Dr. Leonard maintained that internet radio stations nonetheless *often* feature greater user functionality than is possible with a linear simulcast stream. He asserted *many* internet radio services (including AccuRadio) allow listeners to pause and skip songs on an internet radio station, which is not available with a simulcast. Dr. Leonard also offered that internet radio services do not feature much if any non-music content. He added that internet radio services are not localized services, they are not broadcasters subject to FCC regulation, and they have no public interest requirement nor any obligation to serve any local community. Finally, Dr. Leonard stated his own understanding that internet radio services are not a significant part of the streaming market. Therefore, he stated, his report did not treat internet radio services as distinct from custom radio services.

The Judges find that these observations do not explain or cure the absence of internet radio options in the Hauser Survey. It is notable that for Dr. Leonard's analysis he proposed to treat internet radio services as undistinguished from (or part of) custom radio services, while Professor Hauser excluded it from the scope of any of the options he provided in his survey. Among the most compelling of *possible* reasons to exclude internet radio from the scope of the provided options might be that internet radio *may* offer distinct features such as allowing listeners to pause and skip songs, making it more closely similar to custom radio. However, the Judges do not have persuasive evidence of how widely-available such features are on internet radio. Furthermore, even if internet radio services are not a significant part of the current streaming market, that does not establish a compelling reason to exclude it from the scope of provided options in Professor Hauser's survey, because the survey was about a hypothetical marketplace over the next five years during which simulcasts are not available. Even if the NAB had offered the Judges compelling evidence of low market usage of internet radio in the

contemporary world, that does not provide adequate reason to exclude an option that shares key characteristics with simulcasts. For instance, the Judges note that both internet radio and simulcasts may be amongst the most “lean back” offerings that do not vary the music played based on an individual listener’s preferences, which is a reasonable basis for including internet radio as a potential switching option.

While the Judges do not fault the Hauser survey for including too many non-music options, that decision does tend to undermine any reasonable rationale for excluding relevant and readily apparent music options, like internet radio and Sirius XM online, that are not excluded in relied-upon industry studies.

For the above-stated reasons, the Judges do not rely on the Hauser survey to support the NAB’s petition for a separate rate for simulcasters.

6. Judges’ Conclusion Regarding Separate Rate for Simulcasters

Based on the entirety of the record in this proceeding and for the foregoing reasons, the Judges do not find that a separate rate category for simulcasters is warranted. Additionally, significant evidence in the record persuades the Judges that simulcasters and other commercial webcasters compete in the same submarket and therefore should be subject to the same rate. Granting simulcasters differential royalty treatment would distort competition in this submarket, promoting one business model at the expense of others.

The Judges’ conclusion regarding the unreliability of the Hauser Survey also renders Dr. Leonard’s opportunity cost modeling unreliable to the extent it depends on the survey results. Additionally, given the Judges’ overall conclusion that the NAB has not sustained its case for a separate rate for simulcasters, we do not proceed through an unnecessary analysis of the NAB’s requested royalty rates.

V. Noncommercial Webcasting Rates

Five entities representing noncommercial broadcasters filed petitions to participate in this proceeding. Three of them — College Broadcasters, Inc. (CBI), the Corporation for Public Broadcasting (CPB), and National Public Radio, Inc. (NPR) — entered into settlements and withdrew from further participation. *See* 85 FR 11857 (Feb. 28, 2020) (public broadcasters’ (NPR/CPB) settlement); 85 FR 12745 (Mar. 2, 2020) (noncommercial educational webcasters’ (CBI) settlement). Of the remaining two noncommercial participants, only one — the National Religious Broadcasters Noncommercial Music Licensing Committee (NRBNMLC) — participated actively. Educational Media Foundation, while technically a participant, participated only through its membership in the NRBNMLC. *See* Educational Media Foundation’s Notice Re Joining in Direct Case of NRBNMLC (Sep. 23, 2019).

In the current rate period, noncommercial webcasters other than public broadcasters pay a minimum fee of \$500 per station or channel, which entitles them to make up to 159,140 aggregate tuning hours (ATH)³⁰⁸ per month of digital audio transmissions.³⁰⁹ Digital audio transmissions in excess of that ATH threshold incur fees

³⁰⁸ “Aggregate Tuning Hours” (ATH) are defined as the total hours of programming that the Licensee has transmitted during the relevant period to all listeners within the United States from all channels and stations that provide audio programming consisting, in whole or in part, of eligible nonsubscription transmissions or noninteractive digital audio transmissions as part of a new subscription service, less the actual running time of any sound recordings for which the Licensee has obtained direct licenses apart from 17 U.S.C. 114(d)(2) or which do not require a license under United States copyright law.

37 CFR 380.7 (2019). Or, more succinctly, the number of hours of programming on all channels and stations multiplied by the number of listeners.

³⁰⁹ Noncommercial educational webcasters (NEWs) also pay a \$500 minimum fee per channel or station that allows them to transmit up to 159,140 ATH per month. 37 CFR 380.22(a). NEWs that exceed that

at the applicable commercial rate. 37 CFR 380.10(a)(2). The current rate structure for noncommercial webcasters (including the 159,140 ATH threshold and \$500 minimum fee) has been in force since the Judges first adopted it nearly 14 years ago in *Web II*. See *Web II*, 72 FR at 24100.

A. Parties' Proposals

1. SoundExchange's Rate Proposal

a. Proposed Rates

SoundExchange proposes a continuation of the current rate structure for noncommercial webcasters but with the same across-the-board increases to the minimum fee and commercial rates that SoundExchange also proposes.³¹⁰ See SoundExchange's Proposed Rates and Terms at 3 (Written Direct Statement of SoundExchange vol. 1 sec. B) (Sep. 23, 2019) (SoundExchange Rate Proposal). Under SoundExchange's proposal, noncommercial webcasters would pay an annual minimum fee of \$1000 per channel or station. This minimum fee would cover up to 159,140 ATH per month of digital audio transmissions. Noncommercial webcasters would be obligated to pay the applicable commercial rate for usage in excess of 159,140 ATH per month. See *id.*

b. Rationale and Justification

In proposing to continue the existing rate structure, SoundExchange endorses and adopts the rationale for the existing rate structure that the Judges articulated in *Web II*,

threshold in any month must pay the rates established for all other noncommercial webcasters. 37 CFR 380.22(b). NEWs that do not transmit more than 80,000 ATH on any channel or station for more than one month in the preceding year may also pay a "proxy fee" of \$100 per year that entitles them to a waiver of the requirement to file reports of use. 37 CFR 380.23(g)(1). Other NEWs may elect to provide reports of use on a sample basis. 37 CFR 380.23(g)(2).

³¹⁰ SoundExchange's minimum fee proposals are discussed *infra*, section VI. SoundExchange's proposed rates for commercial webcasters are discussed *supra*, section IV.

when they originally put that rate structure in place. *See* SX PFFCL ¶¶ 1346-1354.

SoundExchange asserts that there is no adequate marketplace benchmark for licenses to noncommercial webcasters. SoundExchange’s expert, Mr. Orszag, testified that, to his knowledge, “there is no market for licensing noncommercial services, and therefore no voluntary agreements negotiated in unregulated markets that could serve as potential benchmarks specific to such services.” Orszag WDT ¶ 184.

Rather than basing its proposal on a benchmark analysis, therefore, SoundExchange’s proposal rests on the economic insight articulated in *Web II* that larger noncommercial webcasters have the same or similar competitive impact in the marketplace as similarly sized commercial webcasters. *See Web II*, 72 FR at 24097; *see also Web IV*, 81 FR at 26395 (“the Judges apply commercial rates to noncommercial webcasters above the ATH threshold because economic logic dictates that outcome, not because it was observed in benchmark agreements”). In *Web II*, the Judges recognized that noncommercial webcasters “may constitute a distinct segment of the noninteractive webcasting market that in a willing buyer/willing seller hypothetical marketplace would produce different, lower rates” than those for commercial webcasters but only “up to a point”, *i.e.*, the point at which a noncommercial webcaster poses a “threat of making serious inroads into the business of those services paying the commercial rate.” *Web II*, 72 FR at 24097. The Judges employed the noncommercial webcaster’s size, as measured by its listenership, as a “proxy” for determining when a noncommercial webcaster poses a competitive threat to commercial webcasters. *See id.* at 24098-99. Based on the then-average online listenership to NPR stations of 218 simultaneous users, the Judges set a threshold of 159,140 ATH per month for applying commercial webcasting rates.³¹¹ *See id.* at 24099.

³¹¹ (24 hrs. × 365 days × 218 users) ÷ 12 mos. = 159,140 ATH/mo.

Although Mr. Orszag opined that he saw “no reason why commercial and noncommercial services would be treated differently with respect to the rates they pay” in an unregulated market, *id.* ¶ 185, he nevertheless supported the existing rate structure based on a history of settlements in rate proceedings. Mr. Orszag acknowledged that SoundExchange had reached settlements in the past with smaller noncommercial webcasters for a “nominal per-channel rate.” *Id.* ¶ 186. For larger noncommercial webcasters, “there has long existed a demarcation at 159,140 aggregate tuning hours ... per month” under the compulsory license, “with services that exceed that threshold paying commercial rates on the incremental usage.” *Id.* ¶ 187. He contended “[t]here is no empirical evidence to suggest, and no reason based in economic theory to think, that record companies would license large noncommercial services that compete meaningfully with commercial services at a fraction of the commercial rate.” *Id.* He noted, moreover, “this structure is supported by precedent and settlements of prior proceedings before the Judges.” *Id.*

SoundExchange also presented expert testimony from Professor Catherine Tucker concerning the impact of the current rate structure on noncommercial webcasters. She testified that under the current noncommercial rates the vast majority of noncommercial webcasters pay only the minimum fee. *See* Trial Ex. 5604 ¶ 165 (Tucker WDT). In 2018 (the most recent year for which Professor Tucker had data), [REDACTED] out of a total of [REDACTED] noncommercial webcasters ([REDACTED]%) paid only the minimum fee per station. *See id.* Professor Tucker also testified that, among those noncommercial webcasters that exceed the music ATH threshold and must pay per-performance royalties, “[REDACTED].” *Id.* ¶ 166. Across the five noncommercial webcasters paying the most

for excess usage, “[REDACTED] [REDACTED].”³¹² *Id.* Professor Tucker also opined that these noncommercial webcasters would be “well positioned” to pay royalties under this rate structure even with the increases in the minimum fee and per-performance rates that SoundExchange proposes: [REDACTED].” *Id.* ¶ 167.

c. NRBNMLC Response

NRBNMLC controverts nearly every element of SoundExchange’s proffered rationale for its rate proposal (and, by extension, the Judges’ rationale in *Web II*, *Web III*, and *Web IV* for the existing rate structure). *See* Services RPFCL ¶¶ 1343-1348. Specifically, NRBNMLC rejects SoundExchange’s assertions that no adequate marketplace benchmark exists for licenses to noncommercial webcasters, that there is no difference between commercial and noncommercial webcasters from the standpoint of the consumer, and that “there has long been acceptance of the current royalty rate structure for noncommercial webcasters.” *Id.* ¶¶ 1344, 1345, 1346.

Regarding Mr. Orszag’s assertion concerning the lack of appropriate benchmarks, NRBNMLC economic expert Professor Richard Steinberg testified that the settlement agreement SoundExchange reached on behalf of record companies with NPR/CPB and, to a lesser extent, SoundExchange’s settlement with CBI, constitute suitable benchmarks. *See* Trial Ex. 3060 ¶¶ 30-39 (AWDT of Richard Steinberg) (Steinberg WDT). NRBNMLC asserts that “[t]he entities negotiating these agreements are precisely the type of entities who negotiated past agreements that the Judges and their predecessors have relied on as benchmarks in past webcasting proceedings.” Services RPFCL ¶ 1344. As examples, NRBNMLC refers to the agreement the Recording Industry Association of America (RIAA) negotiated with Yahoo! on behalf of record companies that “the *Web I*

³¹² The five noncommercial webcasters paying the most royalties for excess usage were [REDACTED].

Tucker WDT ¶ 166.

CARP chose as its key benchmark;” settlement agreements between SoundExchange and CBI, the National Association of Broadcasters (NAB), and Sirius XM, respectively, that the Judges cited in *Web III*; and a direct license between Merlin (an entity representing independent record companies) and Pandora that the Judges relied on in *Web IV*.³¹³ *Id.*

NRBNMLC argues that, contrary to Mr. Orszag’s assertion, “there are very real differences to consumers between noncommercial and commercial webcasters.” The National Religious Broadcasters Noncommercial Music License Committee’s Corrected Proposed Findings of Fact and Conclusions of Law ¶ 1345 (NRBNMLC PFFCL). For example, Jennifer Burkhiser, Director of Broadcast Regulatory Compliance and Issues Programming at Family Radio, Inc. (a large noncommercial religious broadcaster), testified that “[t]hose who really listen to Christian music and ... radio stations can tell the difference between commercial and non-commercial pretty easily.... [T]here’s a big difference in motivation and just the programming content based on the two different drivers, profit or mission.” 8/31/20 Tr. 4764 (Burkhiser); *see also* Steinberg WDT ¶ 19 (contrasting profit maximization and mission maximization); Trial Ex. 3061 ¶ 29 (CWDT of Joseph Cordes) (Cordes WDT) (stating that programming on noncommercial service, including music, “is chosen for mission-driven reasons rather than commercial popularity”). Professor Steinberg also emphasized the absence of advertising from noncommercial programming. *See* 8/26/20 Tr. 3997 (Steinberg). Moreover, Professor Steinberg asserts as a matter of economic logic that, “[e]ven if the webcasters play identical songs in an identical context, whether they are commercial or non-commercial,

³¹³ NRBNMLC does not cite any economic testimony for this analysis of the suitability of

SoundExchange’s settlement agreements with NPR/CPB and CBI as benchmarks, or their comparability to benchmarks that the Judges used in past proceedings. The discussion is, rather, arguments of counsel.

as long as there is different willingness to pay, there's a different market segment, and we would naturally expect different prices in each segment." 8/26/20 Tr. 4002 (Steinberg).

NRBNMLC rejects SoundExchange's assertion that the existing rate structure for noncommercial webcasters has long been accepted, stating, "there has never been noncommercial buyer acceptance of a structure incorporating above-threshold commercial-level per-performance fees." Services RPPFCL ¶ 1346. Counsel for NRBNMLC supports that statement with the observation that NRBNMLC has "never proposed such a structure" in past webcasting proceedings, and, up until *Web IV* rates went into effect, most noncommercial webcasters paid lower Webcaster Settlement Act (WSA) rates, instead of the rates set by the Judges. *See id.*

NRBNMLC also disputes a key underpinning of the current rate structure: that larger noncommercial webcasters pose a greater competitive threat to commercial webcasters. NRBNMLC economics expert Professor Joseph Cordes testified that there is "no particular economic reason to believe" that as noncommercial webcasters grow in size "their attributes will converge to those of commercial broadcasters." 8/20/20 Tr. 3271-72 (Cordes). A noncommercial broadcaster's "commitment to mission will, in fact, act as a restraint on their proclivity to simply want to go into a market and compete with commercial broadcasters.... So long as a nonprofit, indeed, has a strong commitment to mission, that is going to actually have an aversion to competing with its commercial counterparts, because that simply means it's going to have to devote scarce, time, energy and resources to competition rather than achieving its mission." *Id.* at 3273. In addition, Professor Steinberg testified that even larger noncommercial webcasters are unlikely to cannibalize markets for commercial webcasters. *See* Steinberg WDT ¶¶ 25, 42-53.

NRBNMLC argues that Professor Tucker's testimony concerning the largest noncommercial webcasters being "well positioned" to pay increased fees under SoundExchange's proposal is irrelevant and unsupported. NRBNMLC PFFCL ¶ 259.

NRBNMLC cites the Register of Copyrights' recommendation to the Librarian of Congress in *Web I* for the proposition that an analysis of a licensee's ability to pay is not relevant to the willing buyer / willing seller standard applied under section 114. *See id.* ¶ 260 (citing *Web I*, 67 FR at 45254). NRBNMLC notes, moreover, that the five entities that Professor Tucker examined were all "broadcasters whose primary focus is not simulcasting, which is only a small part of their overall operations" and that, as broadcasters, they "would incur numerous expenses in connection with their broadcast operations, including 'maintaining and operating their stations and translators' and 'applying for and maintaining FCC licenses'." *Id.* ¶ 262 (quoting 8/18/20 Tr. 2484-86).

2. NRBNMLC's Rate Proposal

a. Proposed Rates

Four days before the beginning of the evidentiary hearing in this proceeding, NRBNMLC submitted two proposed rate structures, which it refers to as "Alternative 1" and "Alternative 2."³¹⁴ *See generally* NRBNMLC Amended Proposed Rates and Terms (Jul. 31, 2020) (NRBNMLC Rate Proposal). Since NRBNMLC does not refer to its original rate proposal in its proposed findings and conclusions, the Judges deem the original rate proposal to be superseded by the amended rate proposal, and consider only the latter.

Under NRBNMLC's Alternative 1, noncommercial webcasters would pay an annual minimum fee of \$500 that would entitle them to make up to 1,909,680 ATH of digital audio transmissions in a year.³¹⁵ For transmissions in excess of that threshold,

³¹⁴ The Judges' procedural rules permit filing of an amended rate proposal at any time up to, and including, the filing of proposed findings and conclusions. *See* 37 CFR 351.4(b)(3). The NRBNMLC's revised rate proposal was thus timely under the rules.

³¹⁵ 1,909,680 ATH is an annualized version of the existing 159,140 monthly ATH threshold (159,140 × 12).

noncommercial webcasters would pay one third of the applicable per performance rate for the same type of transmissions by commercial webcasters.³¹⁶ *See id.* ex. A at 9.

NRBNMLC modelled its Alternative 2 on SoundExchange's settlement with NPR/CPB. *See id.* ex. B at 11-15 (redline showing changes from NPR/CPB settlement); NRBNMLC PFFCL ¶ 152. Under Alternative 2, NRBNMLC would pay a flat annual fee of \$1,200,000 to SoundExchange on behalf of its members for usage by up to 795 noncommercial religious radio stations that NRBNMLC would name. *See id.* ex. A at 10-11. The proposal would permit NRBNMLC to add additional noncommercial radio stations by paying the minimum fees applicable to other noncommercial webcasters. *See id.* ex. A at 12. The religious radio stations that NRBNMLC names would be subject to an aggregate usage cap of 540,000,000 ATH in the first year, increasing by 15,000,000 ATH each year of the rate term. *See id.* ex. A at 11. The proposal does not establish any consequence for exceeding those thresholds.

Like the CBI and NPR/CPB settlement rates, Alternative 2 only applies to a subset of noncommercial webcasters — those noncommercial religious radio stations named by NRBNMLC. NRBNMLC proposes that all other noncommercial webcasters would be subject to Alternative 1. *See id.*, ex. A at 10.

b. Rationale and Justification

NRBNMLC argues that noncommercial webcasters occupy a separate market segment, in which noncommercial webcasters and record companies would agree to royalty rates well below rates in the commercial webcasting market. *See, e.g.*, 8/20/20 Tr. 3256 (Cordes); 8/26/20 Tr. 3998 (Steinberg); Cordes WDT ¶ 16. On the buyers' side

³¹⁶ Alternative 1 provides for separate above-threshold per-performance rates for noncommercial simulcasting, noncommercial nonsubscription webcasting, and noncommercial subscription webcasting. *See* NRBNMLC Amended Proposed Rates and Terms at 9. This structure parallels the rate structure that the Services propose for commercial webcasting.

of that submarket, noncommercial webcasters of all sizes are characterized by a lower willingness to pay as a result of the legal constraints placed on nonprofit entities. *See, e.g.*, 8/20/20 Tr. 3255-56, 3259-65 (Cordes). On the sellers' side of the submarket, record companies would agree to lower prices as a form of seller-side price discrimination in order to maximize their overall profits. *See, e.g.*, 8/26/20 Tr. 4001-02 (Steinberg); Steinberg WDT ¶ 45 n.14; Cordes WDT ¶ 21.

NRBNMLC advocates a benchmark approach to setting a noncommercial rate, contending that a benchmark approach is superior to using theoretical models to support a rate proposal. NRBNMLC PFFCL ¶ 125. “[A] benchmark is, I think, always superior to a bunch of theorizing if one is available” 8/26/20 Tr. 4028 (Steinberg). Specifically, NRBNMLC offers the 2019 NPR/CPB settlement with SoundExchange (2019 NPR/CPB Agreement) as a benchmark that supports its rate proposal.³¹⁷ *See, e.g.*, NRBNMLC

³¹⁷ In his WDT, Professor Steinberg cites RIAA's offer in *Web I* to set a noncommercial rate at one-third the commercial rate as evidence to support a per-play rate at that level for performances in excess of an ATH threshold — a structure that corresponds with NRBNMLC's Alternative 1 rate proposal. *See* Steinberg WDT ¶ 61. NRBNMLC does not refer to this element of Professor Steinberg's written testimony in its proposed findings, nor did Professor Steinberg refer to it in his oral testimony. The Judges deem this argument to have been abandoned in favor of Professor Steinberg's use of the 2019 NPR/CPB Agreement to support NRBNMLC's rate proposal. To the extent that NRBNMLC does maintain that argument, the Judges find Professor Steinberg's reliance on a rejected proposal made in the course of litigation two decades ago to be unpersuasive.

Professor Cordes, in his WDT, offers the SoundExchange-CBI settlement for the *Web IV* rate period as a benchmark. Again, the Judges deem this argument to have been abandoned by NRBNMLC in favor of reliance on Professor Steinberg's use of the more recent 2019 NPR/CPB agreement as a benchmark. To the extent that NRBNMLC does maintain the CBI *Web IV* settlement as a benchmark, the Judges note that the practical effect of the *Web IV* CBI settlement was to replicate the rate structure generally applicable to noncommercial webcasters under the *Web IV* determination. As the Judges noted in *Web IV*, although the

PFFCL ¶¶ 120-121. NRBNMLC contends that employing the 2019 NPR/CPB Agreement as a benchmark “is far superior to using agreements with commercial webcasters to set all or any part of those rates.” NRBNMLC PFFCL ¶ 122. According to Professor Steinberg, “there are no appropriate benchmarks from the commercial submarket because ... the non-commercial sector has a different willingness to pay.” 8/26/20 Tr. 4028 (Steinberg). Notwithstanding NRBNMLC’s submission of the 2019 NPR/CPB settlement with SoundExchange as a benchmark, NRBNMLC did not present a comprehensive analysis of that settlement by its expert witnesses. This is likely because NRBNMLC did not offer its rate proposal until after it had already submitted the written direct and rebuttal testimony of its witnesses.

As discussed *supra*, counsel for NRBNMLC argues that “[t]he NPR benchmarks are by far the most comparable agreements to the agreements that noncommercial buyers would negotiate with sellers in the target market in this case.” NRBNMLC PFFCL ¶ 121.³¹⁸ Counsel contends that the 2019 NPR/CPB Agreement involves the same types of buyers, the same sellers, the same works, the same rights, and the same license term as the target noncommercial compulsory license rate. *See id.* The Judges have used similar factors to assess the comparability of proffered benchmarks in past determinations. *See, e.g., Web III Remand*, 79 FR at 23115.

parties to the settlement left the royalty rate for noncommercial educational webcasters (NEWs) undefined (NEWs that exceed the 159,140 ATH threshold are simply no longer eligible for the settlement rate), both parties were aware of SoundExchange’s rate proposal for noncommercial webcasters that the Judges ultimately adopted. *See Web IV*, 81 Fed. Reg. at 26394. The Judges find Professor Cordes’ assertion that both parties could have considered the agreement as effectively being a flat rate to be unreasonable and not credible. *See Cordes WDT* ¶ 36.

³¹⁸ *See supra* note 313 and accompanying text.

As to the specifics of NRBNMLC's Alternative 1 rate proposal, Professor Steinberg testified that, based on his review of SoundExchange's *Web IV* and *Web V* settlements with NPR/CPB, he concluded "it's reasonable to have a minimum fee of \$500 and a one-third the commercial broadcaster rate for additional usage."³¹⁹ 8/26/20 Tr. 4039-40 (Steinberg).

To reach that conclusion, Professor Steinberg relied on a statement in SoundExchange's 2015 settlement agreement with NPR and CPB (2015 NPR/CPB Agreement) that breaks down the components of value included in the agreement's flat fee, and on an Excel workbook entitled "[REDACTED] Analysis."³²⁰ According to Professor Steinberg, SoundExchange prepared the [REDACTED] Analysis "[REDACTED]" for purposes of [REDACTED] to be included in the 2015 NPR/CPB Agreement. Trial Ex. 3064 ¶ 3 (WRT of Richard Steinberg) (Steinberg WRT); *see* 8/26/20 Tr. 4030 (Steinberg). He contended that the [REDACTED] Analysis [REDACTED].³²¹ *See* Steinberg WRT ¶ 8; 8/26/20 Tr. 4029-30 (Steinberg).

The 2015 NPR/CPB agreement states:

It is understood that the License Fee includes:

- (1) An annual minimum fee of \$500 for each Covered Entity for each year during the Term;
- (2) Additional usage fees for certain Covered Entities; and

³¹⁹ Professor Steinberg views that rate as an upper bound of reasonable rates, arguing the rate "may be a little high; that is, higher rates than we would see in a ... willing buyer/willing seller framework with the religious non-commercial stations because they don't have access to government money." *Id.* at 4040 (Steinberg).

³²⁰ The [REDACTED] Analysis was admitted into evidence as Trial Ex. 3022.

³²¹ Professor Steinberg analyzed the [REDACTED] Analysis in his written *rebuttal* testimony because NRBNMLC received the document in discovery after the submission of his written direct testimony. *See* Steinberg WRT ¶¶ 1, 3.

(3) A discount that reflects the administrative convenience to the Collective of receiving annual lump sum payments that cover a large number of separate entities, as well as the protection from bad debt that arises from being paid in advance.

37 CFR 380.32(b); *see also* Steinberg WRT ¶ 8.

According to Professor Steinberg, the [REDACTED] Analysis provides, *inter alia*, [REDACTED]. *See id.* ¶ 5. [REDACTED]³²² *Id.* ¶ 5; *see id.* ¶6. Professor Steinberg equated the [REDACTED] from the [REDACTED] Analysis with the first element of value cited in the 2019 NPR/CPB agreement and equated the [REDACTED] with the second element of value cited in that agreement. *See id.* ¶ 8; 8/26/20 Tr. 4031, 4034-35 (Steinberg).

Professor Steinberg noted that the [REDACTED] rates employed in the [REDACTED] Analysis are approximately [REDACTED] the then-prevailing per performance rates for commercial broadcasters. *See* Steinberg WRT ¶¶ 3, 6 & n.6. He thus concluded that the [REDACTED] used in the [REDACTED] analysis support a rate for noncommercial webcasters consisting of a \$500 minimum fee and a per-performance fee for performances over the ATH threshold of one-third the prevailing rate for commercial broadcasters. *See* 8/26/20 Tr. 4039-40 (Steinberg).

As for the third element of value listed in the agreement (the discount for administrative convenience and protection against bad debt), Professor Steinberg stated:

³²² The [REDACTED] Analysis used [REDACTED] of \$[REDACTED] for 2014 and \$[REDACTED] for 2015, while the commercial broadcaster rates for those years were \$0.0023 and \$0.0025. *See* Trial Ex. 3022; 37 CFR 380.12(a)(4)-(5) (2011). The [REDACTED] Analysis does not actually refer to the commercial broadcaster rates or the 3:1 ratio posited by Professor Steinberg. Instead, it labels the rates as “[REDACTED].” Trial Ex. 3022. The Judges, like SoundExchange, infer that “[REDACTED]” denotes the noncommercial webcaster settlement agreement under the Webcaster Settlement Act, which is a nonprecedential agreement. *See* SX RPFCL (to NRBNMLC) ¶ 140. The Judges discuss this *infra*, at section V.B.1.c.iv.

The most plausible explanation to account for the administrative convenience value component is that [SoundExchange] recognizes that its [REDACTED].... We do not know what SX believed [REDACTED], but if it believed [REDACTED].

Steinberg WRT ¶ 9.

Professor Steinberg acknowledged that he lacked the data to conduct a similar analysis with respect to the 2019 NPR/CPB Agreement that NRBNMLC offers as a benchmark but contended “the numbers in that agreement are consistent with this interpretation.” *Id.* ¶ 10. He based this contention on what he described as a “check to see whether the calculations were done in the same way” 8/26/20 Tr. 4039 (Steinberg). He compared the average cost per music ATH under the 2015 NPR/CPB Agreement (\$0.0020) with the corresponding metric for the 2019 NPR/CPB Agreement (\$0.0021) and concluded that the calculation underlying the 2019 NPR/CPB Agreement “does replicate the calculation” underlying the 2016 NPR/CPB Agreement. *Id.*; *see also* Steinberg WRT ¶ 10. “It would be better if I [REDACTED]” *Id.*

With respect to Alternative 2, Professor Steinberg stated “we can design a flat-fee structure the same way NPR did it” with adjustments to scale up the fees and ATH caps to reflect a larger number of covered entities than in the 2019 NPR/CPB Agreement. 8/26/20 Tr. 4041 (Steinberg).

You’d want to adjust the 800,000 [dollar annual fee] of [the] NPR [settlement] for the difference in the music ATH cap and the number of covered stations between the ... religious non-commercials and the NPR non-commercials. But other than that, you’d structure for a – an additional minimum fee, you can add stations, and you could structure into a flat-fee structure all of the factors listed for administrative convenience as well.

Id. In essence, Professor Steinberg described the arithmetic process of scaling up the terms of the NPR/CPB settlement by 150% to cover a larger number of radio stations and a greater amount of music. *See* SX PFFCL ¶ 1615.

c. SoundExchange's Response

SoundExchange rejects NRBNMLC's use of the 2019 NPR/CPB agreement for multiple reasons. Moreover, SoundExchange contends that the 2019 NPR/CPB agreement fails to support NRBNMLC's rate proposals. Finally, SoundExchange questions the Judges' authority to adopt one of NRBNMLC's proposed alternatives.³²³

According to SoundExchange, Professor Steinberg "utterly failed to do a proper benchmarking analysis." SX PFFCL ¶ 1497. Mr. Orszag described benchmarking as "a process that uses rates freely negotiated in *unregulated* markets as a benchmark to set rates in a similar, regulated market." Orszag WDT ¶ 43 (emphasis added).

SoundExchange notes that the parties to the 2019 NPR/CPB Agreement did not set a freely negotiated rate in an *unregulated* market, but the agreement was instead "a settlement of a regulatory proceeding" and thus "not a proper benchmark." SX PFFCL ¶ 1497 (citing *SDARS III*, 83 FR at 65220 (acknowledging that a proffered settlement rate was "not a marketplace benchmark" but "instead a regulated rate")). SoundExchange notes that, as a settlement of a statutory rate, the 2019 NPR/CPB Agreement (and its predecessors) "reflect not only their negotiating history and the parties' valuations of the

³²³ In its reply to NRBNMLC's proposed findings, SoundExchange also argues that NRBNMLC's presentation of an [REDACTED] as part of its rebuttal case was procedurally improper and deprived SoundExchange of a reasonable opportunity to rebut that analysis. *See* SX RPFCL (to NRBNMLC) ¶¶ 121, 241. However, SoundExchange did not seek to exclude Professor Steinberg's written rebuttal testimony in its pre-hearing motions. Nor did SoundExchange challenge any of the discussion of the [REDACTED] Analysis in the Steinberg WRT in its line-by-line objections. Nor did counsel for SoundExchange object when NRBNMLC offered the Steinberg WRT for admission at the hearing. *See* 8/26/20 Tr. 3993 (Steinberg). The Judges do not consider an objection first expressed in a party's proposed reply findings to be properly raised. Even if SoundExchange had raised its objection at the proper time, the Judges need not address this procedural argument in light of the Judges' rejection of the 2019 NPR/CPB Agreement as a benchmark on substantive grounds. *See infra* section V.B.1.

elements of the deal, but also considerations such as the parties' predictions of litigation outcomes and potential savings of litigation costs, and the potential for a party dissatisfied with a litigation outcome to seek redress from Congress." SX RPFCL (to NRBNMLC) ¶ 149 (citations omitted).

Even if the Judges were to find a settlement agreement informative, SoundExchange argues that NRBNMLC has not established that the 2019 NPR/CPB agreement is sufficiently comparable to serve as a benchmark. SoundExchange and NRBNMLC both acknowledge the critical importance of comparability in assessing the value of a proffered benchmark. *See* NRBNMLC PFFCL ¶¶ 120-121; SX RPFCL (to NRBNMLC) ¶ 120 (citing *SDARS I*, 73 FR at 4088). According to SoundExchange, NRBNMLC bears the burden of establishing the comparability of its proposed benchmark to the target market, and has failed to do so. *See* SX RPFCL (to NRBNMLC) ¶ 130 (citing *Web IV*, 81 FR at 26320).

SoundExchange asserts that neither of NRBNMLC's economic experts "conducted a meaningful analysis of the comparability of SoundExchange's settlement with CPB/NPR to the hypothetical market for which the Judges must set rates in this proceeding." SX RPFCL (to NRBNMLC) ¶ 121. According to SoundExchange, the only assessment of comparability put forward by NRBNMLC "is solely the work of counsel for NRBNMLC." *Id.*

SoundExchange argues that the NPR/CPB agreements are not comparable benchmarks and that the Judges should reject them as they have in previous webcasting determinations. *See* SX PFFCL ¶ 1363 (citing *Web IV*, 84 FR at 26394).

SoundExchange enumerates a number of differences between the NPR/CPB agreement

and the hypothetical target market that it contends render that agreement valueless as a benchmark.³²⁴ *See* SX RPFCL (to NRBMLC) ¶ 121.

SoundExchange also contends that the 2019 NPR/CBP agreement supports neither of NRBMLC’s alternative rate proposals. In addition to the other alleged infirmities of the agreement as a benchmark, SoundExchange notes that each of the alternative proposals lacks material elements of the proffered benchmark and/or includes elements that are not part of the proffered benchmark. Alternative 1 lacks the advance payment of royalties on an annual basis and the requirement of consolidated reporting as in the 2019 NPR/CPB agreement. *See* SX RPFCL (to NRBMLC) ¶ 154. It does, however, annualize the ATH threshold, which was not part of the [REDACTED] Analysis that Professor Steinberg reviewed. *See id.* Moreover, according to SoundExchange, the one-third of commercial rates for excess performances does not appear in the 2019 NPR/CPB agreement and is instead drawn from the [REDACTED] Analysis — an analysis of non-precedential WSA agreements that the Judges are not permitted to consider. *See id.*

With regard to NRBMLC’s Alternative 2, SoundExchange points out it also does not include consolidated reporting but does include a much larger number of covered entities and music ATH. *See id.* ¶ 159. According to SoundExchange, the requirement for consolidated reporting, in particular, is a “major benefit” of the NPR/CPB agreement for SoundExchange. *Id.* (quoting 8/17/20 Tr. 2232 (Tucker)).

In addition, SoundExchange argues that the Judges lack statutory authority to adopt Alternative 2 through a determination (as distinguished from a settlement). *See* SX RPFCL ¶ 1518. According to SoundExchange, 17 U.S.C. 114(f)(1) directs the Judges to

³²⁴ As with NRBMLC’s contrary assertions, *see supra* note 313 and accompanying text, these contentions are in the form of arguments of counsel, rather than expert testimony.

determine rates binding on copyright owners and “entities performing sound recordings.” *Id.* (quoting 17 U.S.C. 114(f)(1)(B)). “[T]here is no obvious statutory basis for adopting in a litigated proceeding a royalty to be paid by a committee of a trade association” like NRBNMLC, as opposed to an entity performing sound recordings. *Id.* ¶ 1520.

SoundExchange distinguishes NRBNMLC’s Alternative 2 from its own settlement agreement with CPB and NPR, because 17 U.S.C. 801(b)(7) “has special provisions that permit adoption of the CPB/NPR agreement as a settlement.” *Id.*

B. Judges’ Findings and Conclusions

1. Rejection of NPR/CPB Agreement as a Benchmark

NRBNMLC, as the participant offering the 2019 NPR/CPB Agreement as a benchmark in this proceeding, bears the burden of demonstrating that the agreement is sufficiently comparable to the target market to serve as a benchmark. To the extent that the benchmark market differs the target market, NRBNMLC bears the burden of adjusting the benchmark to account for those differences. NRBNMLC has failed to meet either burden. The Judges, therefore, reject the use of the 2019 NPR/CPB Agreement as a benchmark for setting noncommercial webcaster rates in this proceeding.

a. NRBNMLC Presented Insufficient Analysis of the Effect of Ongoing Litigation on the Benchmark Rate

The 2019 NPR/CPB Agreement is a settlement of ongoing rate litigation before the Judges. SoundExchange argues that that fact alone renders the agreement “not a proper benchmark.” SX PFFCL ¶ 1497. The Judges do not agree that a settlement of a rate proceeding is categorically barred from use in a benchmarking exercise. Section 114(f)(1)(B)(ii) permits the Judges to consider rates and terms from comparable voluntary license agreements, and it does not create an exception for voluntary agreements reached as a settlement of litigation. *Cf. Phonorecords III*, 84 FR at 1932-33 (finding “it is beyond dispute that Congress has authorized the Judges, in their discretion,

to consider such agreements as evidence” under then-effective provisions of 17 U.S.C. 115(c)(3)(D)). Nevertheless, settlement agreements, unlike voluntary agreements reached outside the context of litigation, are not “free from trade-offs motivated by avoiding litigation cost, as distinguished from the underlying economics of the transaction.” *Phonorecords III*, 84 FR at 1935. To be informative on the question of willing buyer/willing seller rates, the proffered settlement must take into account trade-offs motivated by avoiding litigation cost.

NRBNMLC’s economic experts did not perform any analysis to disaggregate trade-offs motivated by avoiding litigation cost from the underlying economics of the deal. Neither of NRBNMLC’s economic experts even acknowledged the existence of the issue. Professor Cordes did not analyze the 2019 NPR/CPB Agreement at all and Professor Steinberg’s analysis of the 2015 NPR/CPB Agreement sought to derive from the flat annual fee a rate for performances in excess of the ATH threshold without any attempt to make adjustments to account for considerations relating to litigation costs (or any justification for not doing so).

The Judges find that, in the absence of evidence concerning the effect of avoidance of litigation costs on the royalty rate agreed to by SoundExchange and NPR/CPB in their settlement agreement, NRBNMLC’s analysis of the 2015 NPR/CPB Agreement is not adequately informative of a willing buyer/willing seller rate in the target market.

**b. NRBNMLC Did Not Demonstrate that the Benchmark was
Comparable**

Section 114 states that the Judges “may consider the rates and terms for *comparable* types of audio transmission services and *comparable* circumstances under voluntary license agreements.” 17 U.S.C. 114(f)(1)(B)(ii) (emphasis added). Congress thus directed the Judges to inquire into the comparability of a proffered voluntary license

agreement. The Judges have long acknowledged that comparability is a key consideration in determining the usefulness of a proffered benchmark. *See, e.g., Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 73 FR 4080, 4088 (Jan. 24, 2008) (*SDARS I*).

NRBNMLC presented no economic analysis concerning the comparability of its proffered benchmark. Instead, counsel for NRBNMLC prepared its own analysis as part of NRBNMLC's proposed findings. *See* NRBNMLC PFFCL ¶ 121. Drawing on factors that the Judges found relevant in past cases,³²⁵ NRBNMLC contended that the proposed benchmark and target hypothetical market have the same types of buyers, same sellers, same works, same rights, and the same license term. *See* NRBNMLC PFFCL ¶ 121. Counsel for SoundExchange — also without the benefit of economic testimony — argues that the 2019 NPR/CPB Agreement is insufficiently comparable to the target hypothetical market. SX RPFCL (to NRBNMLC) ¶ 121. SoundExchange contends that there are *different* buyers (CPB as opposed to individual webcasters), *different* sellers (SoundExchange as opposed to individual record companies), *different* sets of works (all commercial sound recordings as opposed to an individual record company's repertoire), and *different* rights and obligations. *See id.*

The 2019 NPR/CPB Agreement (and its predecessor agreements) licenses the use of sound recordings by noncommercial entities for noninteractive transmissions. The agreement is between SoundExchange — a collective operating on behalf of record companies and recording artists — and CPB — a private entity, created by the government, that provides funding for public broadcasting entities, including NPR

³²⁵ *See, e.g., Determination of Rates and Terms for Preexisting Subscription Services and Satellite Digital Audio Radio Services*, 78 Fed. Reg. 23054, 23058 (Apr. 17, 2013) (“a benchmark market should involve the same buyers and sellers for the same rights”) (*SDARS II*).

stations. Under the agreement, CPB pays SoundExchange funds appropriated by Congress to cover use of commercial sound recordings by NPR stations. The Judges find that, as a general matter the NPR/CPB agreements share common elements with the target market but, as enumerated by SoundExchange, differ in their particulars.

There is insufficient expert testimony to determine the extent to which the similarities between the 2019 NPR/CPB Agreement and the target market support its use as a benchmark or the degree to which the differences between the agreement and the target market detract from that use (or require adjustments to the benchmark rates). As the party proffering the agreement as a benchmark, it was incumbent on NRBNMLC to adduce sufficient evidence to demonstrate that the agreement is sufficiently comparable to the target market. NRBNMLC failed to do so.

c. Professor Steinberg’s Analysis of the 2019 NPR/CPB Agreement is based on Outdated Information that Applies Rates from a Non-Precedential WSA Settlement Agreement

i. The Contents of the [REDACTED] Analysis

NRBNMLC relies almost exclusively on Professor Steinberg’s analysis of the [REDACTED] Analysis to derive rates from the 2019 NPR/CPB Agreement. *See* Steinberg WRT ¶¶ 4-10. The [REDACTED] Analysis is an Excel Workbook prepared by SoundExchange in “[REDACTED],” *id.* ¶ 3, that consists of [REDACTED] spreadsheets, labelled “[REDACTED],” and “[REDACTED].” Trial Ex. 3022. Professor Steinberg confined his analysis to the “Estimations” spreadsheet. *See* Steinberg WRT ¶¶ 4-10.

The heading for the “[REDACTED]” spreadsheet is “[REDACTED] Analysis.” The spreadsheet is divided into [REDACTED] sections labelled “[REDACTED],” and “[REDACTED].” Trial Ex. 3022, [REDACTED] sheet. Each section contains several lines of data and calculations. *See id.*

The “[REDACTED]” section of the “[REDACTED]” spreadsheet (rows [REDACTED]) seeks to estimate the [REDACTED] [REDACTED]. *See id.*; Steinberg WRT ¶ 4. That estimate is used in the sections that follow.

The “[REDACTED]” section (rows [REDACTED]) calculates the [REDACTED]. *See* Steinberg WRT ¶ 4 n.7. The spreadsheet calculates [REDACTED] by multiplying the [REDACTED] from the previous portion of the spreadsheet by [REDACTED], then multiplying that product by the “[REDACTED]” of [REDACTED]. Trial Ex. 3022, Estimations sheet, rows 19-22.

The “[REDACTED]” section (rows [REDACTED]) estimates [REDACTED] by multiplying the [REDACTED] by the “[REDACTED].” *Id.* rows [REDACTED]; *see* Steinberg WRT ¶ 5. Unlike the previous sections that calculate [REDACTED], this section includes an [REDACTED] as well. *See* Trial Ex. 3022, Estimations sheet, rows 26-28.

The “[REDACTED]” section (rows [REDACTED]) [REDACTED] Trial Ex. 3022, [REDACTED] sheet, rows [REDACTED]; *see* Steinberg WRT ¶ 6. The spreadsheet computes the [REDACTED]. *See id.*

To summarize, the “[REDACTED]” spreadsheet examines [REDACTED] scenarios: one in which [REDACTED]. SoundExchange computed [REDACTED]. *See* Steinberg WRT ¶¶ 4, 6 n.11; Trial Ex. 3022, [REDACTED] sheet, rows [REDACTED], [REDACTED], [REDACTED].

ii. The Purpose of the [REDACTED] Analysis

Professor Steinberg testified that SoundExchange prepared the [REDACTED] Analysis “for the *Web IV* license agreement,” *i.e.*, for purposes of computing the [REDACTED]. Steinberg WRT ¶ 3; *see* 8/26/20 Tr. 4030 (Steinberg). Professor Steinberg apparently infers that it was “done for the *Web IV* license agreement,” 8/26/20 Tr. 4030 (Steinberg), based on when it was performed and the fact that the annual flat fee

in the agreement — \$560,000 — is “at most, [REDACTED]” of \$[REDACTED].

Steinberg WRT ¶ 7. He attributes the [REDACTED] to [REDACTED]. *See id.*

By contrast, SoundExchange argues that the [REDACTED] analysis “does not purport to address the *Web IV* CPB/NPR settlement.” SX RPFCL (to NRBNMLC) ¶ 140. SoundExchange describes it as “an old and backward-looking document” that “[REDACTED]” SX PFFCL ¶¶ 1507-1508.

The purpose for which SoundExchange performed the [REDACTED] Analysis is not apparent from the document itself. Neither scenario examined on the “[REDACTED]” spreadsheet is identified in a way that suggests that the purpose of the analysis is to derive a flat annual fee for a settlement in *Web IV*. As counsel for SoundExchange asserts in proposed findings, the document primarily looks backward at the experience under the *Web III*-era agreement.³²⁶

Extrinsic evidence of the purpose for the [REDACTED] Analysis is also lacking. There is no testimony or documentary evidence in the record that identifies who requested the [REDACTED] Analysis and for what purpose, who prepared it, and to whom it was circulated.

Nevertheless, the timing of the analysis ([REDACTED]) and the rough proximity of the value derived in the [REDACTED] scenario to the royalty rate adopted in the settlement agreement lend some support for the inference that the analysis was prepared for purposes of [REDACTED]. However, while a plausible inference, it is by no means a certainty — or even a strong probability.

³²⁶ The “[REDACTED]” spreadsheet in the [REDACTED] Analysis workbook does not shed any additional light on the question. The “[REDACTED]” are cryptic at best and appear to consist primarily of a [REDACTED]. The Judges draw no inferences one way or the other from the [REDACTED] spreadsheet.

Because there is a plausible basis to infer that the [REDACTED] Analysis was prepared for the 2015 NPR/CPB Agreement, the Judges will not discount the analysis entirely as a tool for deriving an implicit per-performance royalty rate from that agreement. However, given the exceedingly thin record on which that inference is based, the Judges give little weight to the [REDACTED] Analysis and the conclusions Professor Steinberg draws from it.

iii. Reliance on an Analysis Based on Ten-Year-Old Data

As described *supra*, SoundExchange prepared its estimations for the [REDACTED] scenarios in the [REDACTED] Analysis using usage data submitted by [REDACTED] *between [REDACTED] and [REDACTED]*. See Steinberg WRT ¶¶ 4, 6 n.11. SoundExchange used the data together with “[REDACTED]” rates to determine values for the *[REDACTED]* under [REDACTED] scenarios.³²⁷

The utilization of usage data that is as much as a decade old to interpret the 2019 NPR/CPB Agreement is not necessarily improper. However, the Judges require *some* explanation why the use of data from another era and another settlement agreement nevertheless yields reliable results. The Judges find Professor Steinberg’s analysis unconvincing on this point. To apply the [REDACTED] Analysis to the 2019 NPR/CPB Agreement, Professor Steinberg relies on at least three inferences or assumptions that may be plausible individually but are unconvincing in aggregate.

First, as discussed *supra*, Professor Steinberg infers that SoundExchange prepared the [REDACTED] Analysis of the *Web III*-era data to [REDACTED] under the *Web IV*-era settlement. The Judges find that inference plausible but weakly supported by the evidence.

³²⁷ See *supra* section V.B.1.c.i.

Second, Professor Steinberg infers that the annual royalty payments in the *Web V*-era settlement reflect the same underlying per-performance rate as the *Web IV*-era settlement. Professor Steinberg acknowledged that he lacked the information to perform an analysis similar to the [REDACTED] Analysis on the 2019 NPR/CPB Agreement. *See* Steinberg WRT ¶ 10. The best he could do under the circumstances was to assert that the numbers in the 2019 NPR/CPB Agreement are “consistent with” his interpretation of the [REDACTED] Analysis, based on a comparison of the average royalty per music ATH under each agreement. The Judges find this a weak basis for applying to the 2019 NPR/CPB Agreement an analysis that [REDACTED]. Professor Steinberg’s own awareness of the weakness of this inference is reflected in his statement that “[i]t would be better if I had the data to replicate the whole analysis [REDACTED].” Steinberg WRT ¶ 10. In his written testimony, Professor Steinberg did not hold out his analysis as a basis for quantifying a per-performance rate, but only as an indication that the rate would be “[REDACTED].” *Id.*

Third, Professor Steinberg’s analysis assumes that the discount for administrative convenience that is mentioned in the NPR/CPB agreements is separate from the minimum fee and the usage fee that the agreement recites. Professor Steinberg did not consider the possibility that the discount is reflected in either or both of the minimum fee and usage fee that are included in the flat annual payment. Instead, Professor Steinberg speculated that the discount resulted from SoundExchange’s underestimation of excess usage by NPR stations that do not provide census reports of usage. The Judges reject that attempt to identify the discount included in the agreement as unsupported by the evidence.

In sum, the Judges find Professor Steinberg’s application of the [REDACTED] Analysis to the 2019 NPR/CPB Agreement to be questionable, and they accord it little weight.

iv. Reliance on Valuations Based on a Non-Precedential WSA

Settlement

SoundExchange based the valuations it performed in the [REDACTED] Analysis on “[REDACTED]” per-performance rates. *See* Trial Ex. 3022 rows [REDACTED], [REDACTED]; Steinberg WRT ¶ 6 n.10. “NCW” is an abbreviation that SoundExchange uses for “Non-Commercial Webcasters.” *See* 9/9/20 Tr. 5829 (Ploeger). “WSA” is the commonly used abbreviation for “Webcaster Settlement Act.”³²⁸ *See, e.g., Web IV*, 81 FR at 26318. Based on the context and timing of the [REDACTED] Analysis, the Judges conclude that “[REDACTED]” refers to the Webcaster Settlement Act settlement agreement setting rates and terms for noncommercial webcasters that the Copyright Office published in the *Federal Register* on August 12, 2009. *See Notification of Agreements under the Webcaster Settlement Act of 2009*, 74 FR 40614, 40624-28 (Aug. 12, 2009). That settlement agreement set rates and terms that noncommercial webcasters could elect to pay in lieu of rates and terms set by the Judges for the period from 2006-2015.

The Webcaster Settlement Act of 2009 (2009 WSA) states that the provisions of a settlement agreement reached under the 2009 WSA are inadmissible as evidence and may not be taken into account by the Judges in any rate proceeding under section 114 or 112:

Neither [the provisions of the WSA] nor any provisions of any agreement entered into pursuant to [the WSA], including any rate structure, fees, terms, conditions, or notice and recordkeeping requirements set forth therein, shall be admissible as evidence or otherwise taken into account in any administrative, judicial, or other government proceeding involving the setting or adjustment of the royalties payable for the public performance or reproduction in ephemeral phonorecords or copies of sound recordings, the determination of terms or conditions related thereto, or the establishment of

³²⁸ Congress enacted three Webcaster Settlement Acts: the Small Webcaster Settlement Act of 2002, Pub. L. No. 107-321, 116 Stat. 2780 (Dec. 4, 2002); the Webcaster Settlement Act of 2008, Pub. L. No. 110-435, 122 Stat. 4974 (Oct. 16, 2008); and the Webcaster Settlement Act of 2009, Pub. L. No. 111-36, 123 Stat. 1926 (Jun. 30, 2009).

notice or recordkeeping requirements by the Copyright Royalty Judges It is the intent of Congress that any royalty rates, rate structure, definitions, terms, conditions, or notice and recordkeeping requirements, included in such agreements shall be considered as a compromise motivated by the unique business, economic and political circumstances of webcasters, copyright owners, and performers rather than as matters that would have been negotiated in the marketplace between a willing buyer and a willing seller This subparagraph shall not apply to the extent that [SoundExchange] and a webcaster that is party to [a WSA agreement] expressly authorize the submission of the agreement in a proceeding under this subsection.

17 U.S.C. 114(f)(4)(C). Section 6.3 of the NCW-WSA agreement contains similar language, making it clear that SoundExchange and the noncommercial webcasters did not “expressly authorize” use of the agreement in rate proceedings. *See* 74 FR at 40627.

On its face, it is apparent that the per-performance royalty rates that SoundExchange used in the [REDACTED] Analysis are rates derived from a non-precedential WSA agreement that the Judges are not permitted to consider in a rate proceeding. NRBNMLC does little to address this issue. Professor Steinberg’s written rebuttal testimony, in which he analyzes the [REDACTED] Analysis, scarcely acknowledges that the rates he describes (imprecisely) as being [REDACTED] commercial per-performance rates were taken from the non-precedential NCW-WSA agreement.³²⁹ In a proposed reply finding, counsel for NRBNMLC acknowledges that the rate comes from a non-precedential WSA agreement, and quotes from a memorandum opinion by the Register of Copyrights (Register) responding to questions referred by the Judges in *Web IV* — presumably to justify use of a nonprecedential rate in this context. *See* Services RPFCL ¶ 1509 (quoting *Memorandum Opinion on Novel Material Questions of Law*, Docket No. 14-CRB-0001-WR, at 14-15 (Sep. 18, 2015) (*Memorandum Opinion*)). The reference is inapt. The Register opined that the WSA

³²⁹ Professor Steinberg refers to labels in the CPB/NPR Analysis that mention “NCW-WSA,” but does not explain what the acronym means. *See* Steinberg WRT ¶ 6 n.10.

does not prevent the Judges from considering a direct license concluded outside of the WSA that incorporates terms “that are copied from, are substantively identical to, have been influenced by, or refer to, the provisions of a WSA agreement.” *Memorandum Opinion* at 10. The [REDACTED] Analysis does not examine a non-WSA agreement. It seeks to determine what [REDACTED] (parties to a separate non-precedential WSA Agreement)³³⁰ would have paid under the NCW-WSA settlement agreement during the period when that settlement was in force.

The Judges conclude that they may not consider the [REDACTED] Analysis in accordance with the provisions of the Webcaster Settlement Act of 2009 as codified in 17 U.S.C. 114(f)(4)(C).

d. The 2019 NPR/CPB Agreement Does Not Support NRBNMLC’s Rate Proposals

NRBNMLC relies on the 2019 NPR/CPB Agreement to support its rate proposal. As previously discussed, the Judges find inadequate evidentiary and analytical support for reliance on that agreement as a benchmark. Even if the Judges found the 2019 NPR/CPB Agreement to be a sound benchmark, the Judges find that it does not adequately support NRBNMLC’s rate proposal.

SoundExchange has identified several elements from the 2019 NPR/CPB Agreement that are not present in NRBNMLC’s two alternative rate proposals. To the extent these differences result in material differences between the benchmark and the proposed rates, the benchmark does not support the proposed rates without appropriate adjustment (or adequate explanation from a competent witness why an adjustment is unnecessary).

³³⁰ See *Notification of Agreements under the Webcaster Settlement Act of 2009*, 74 Fed. Reg. 40614, 40620-24 (Aug. 12, 2009).

i. Absence of Up-Front Payment

Under NRBNMLC's proposed Alternative 1, each noncommercial webcaster would pay an annual \$500 per station or channel minimum payment plus monthly payments of per-performance royalties at one-third the rate for commercial webcasters for transmissions in excess of 1,909,680 ATH per year. *See* NRBNMLC Rate Proposal ex. A at 2, 9. By contrast, the 2019 NPR/CPB Agreement requires up-front annual payments covering up to 530 NPR stations. *See* 85 FR 11857, 11857-58 (Feb. 28, 2020).

The 2019 NPR/CPB Agreement recites that the rate reflects

- (1) An annual minimum fee for each Public Broadcaster for each year during the Term;
- (2) Additional usage fees for certain Public Broadcasters; and
- (3) A discount that reflects the administrative convenience to [SoundExchange] of receiving annual lump sum payments that cover a large number of separate entities, as well as the protection from bad debt that arises from being paid in advance.

Id. at 11858. The parties to the 2019 NPR/CPB Agreement prominently highlight the “administrative convenience” and “protection from bad debt” that result from the advance payment structure as being economically significant elements of the agreement that justify a discount in the royalty rate. NRBNMLC does not adjust the per-performance rate that it purportedly derives from the 2019 NPR/CPB Agreement to reflect the discount for advance payments. In the absence of any adjustment, the 2019 NPR/CPB Agreement does not support NRBNMLC's Alternative 1 rate proposal.

While NRBNMLC's Alternative 2 rate includes advance payments, the issue would persist even if the Judges adopted Alternative 2. Alternative 2 is not a stand-alone rate proposal, since it only covers a subset of noncommercial webcasters (religious broadcasters selected by NRBNMLC). NRBNMLC proposes that all other noncommercial webcasters (not otherwise covered by a settlement) would fall into Alternative 1. In effect, Alternative 1 is part of the Alternative 2 rate proposal.

ii. Absence of Consolidated Reporting

As part of their settlement, SoundExchange and CPB/NPR agreed to continue the practice of consolidating reports of use through CPB. *See Joint Motion to Adopt Partial Settlement*, Trial Ex. 3020 at 3 (Sep. 23, 2019) (2019 Settlement Motion). The parties aver that they did not include the details of that part of their agreement in the settlement submitted with their motion because the Judges had stated previously that they “do not wish to codify in the Code of Federal Regulations [reporting] arrangements pertinent only to specific licensees.” *Id.* at 3 n.2 (citing *Notice and Recordkeeping for Use of Sound Recordings under Statutory License*, Final Rule, 74 FR 52418, 52419 (Oct. 13, 2009) (“We have no intention of codifying these negotiated variances [from the Judges’ regulations] in the future unless and until they come into such standardized use as to effectively supersede the existing regulations.”)).

By contrast, NRBNMLC’s rate proposal does not require consolidated reporting of usage data. *See* 8/26/20 Tr. 4068-69 (Steinberg). NRBNMLC’s Alternative 2 rate proposal includes a provision stating “NRBNMLC and Noncommercial Religious Broadcasters shall submit reports of use and other information concerning website Performances as agreed upon with [SoundExchange]. In the absence of such an agreement, Noncommercial Religious Radio Stations shall submit reports of use in accordance with then-applicable regulations” NRBNMLC Rate Proposal ex. A at 14. Unlike the settlement with NPR/CPB, there is no advance commitment to provide consolidated reporting. *Compare id. with* 2019 Settlement Motion at 3. NRBNMLC merely states that SoundExchange and the religious broadcasters are free to adopt an arrangement concerning reports of use that departs from the Judges’ regulations. SoundExchange and religious broadcasters would have that ability without NRBNMLC’s proposed language. *See Notice and Recordkeeping for Use of Sound Recordings Under Statutory License*, Final Rule, 74 FR at 52419 (“digital audio services are free to

negotiate other formats and technical standards for data maintenance and delivery and may use those in lieu of regulations adopted by the Judges, upon agreement with [SoundExchange]”).

The record reflects that consolidated reporting has value to SoundExchange. Travis Ploeger, Director of License Management for SoundExchange, testified that CPB (through an entity called NPR Digital Services), collects usage information from NPR stations and provides quality assurance before providing the information to SoundExchange, thus making the information more efficient to process. *See* 9/9/20 Tr. 5803, 5822 (Ploeger); *see also* 8/17/20 Tr. 2232 (Tucker) (“one of the things that NPR does is it collects together the messy data of the individual stations and reports it as part of the agreement”). Professor Steinberg also recognized that consolidated reporting by CPB represents a cost savings to SoundExchange. *See* 8/26/20 Tr. 4068 (Steinberg).

NRBNMLC’s proposed Alternative 2 thus differs materially from the proposed benchmark. NRBNMLC makes no attempt to adjust its proposed rate to compensate for this material difference, and provides no justification for not making an adjustment. *See* 8/26/20 Tr. 4068-69 (Steinberg). Rather, counsel for NRBNMLC faults *SoundExchange* for failing to quantify the value of consolidated reporting. *See* Services RPFCL ¶ 1523. It is not SoundExchange’s (or the Judges’) responsibility to rescue NRBNMLC’s faulty benchmark by proposing an appropriate adjustment. In the absence of an appropriate adjustment, the 2019 NPR/CPB Agreement does not support NRBNMLC’s Alternative 2 rate proposal.

e. Conclusion regarding NRBNMLC’s Proposed NPR/CPB Benchmark

Each of the foregoing critiques counsels for limited or no reliance on the proffered benchmark. In aggregate, the critiques constitute an overwhelming argument for rejecting entirely the 2019 NPR/CPB Agreement as a benchmark. The Judges, therefore, reject NRBNMLC’s use of the 2019 NPR/CPB Agreement as a benchmark.

2. Acceptance of Reasoning Underlying SoundExchange Rate Proposal

SoundExchange relies on the same reasoning adopted by the Judges in webcasting proceedings going back to *Web II* to support its proposed rate structure.³³¹ Absent persuasive counterarguments, the Judges will accept that reasoning.

a. Evaluation of NRBNMLC Counterarguments

NRBNMLC puts forward six principal counterarguments against the rationale that has supported the existing noncommercial rate structure since *Web II*. The Judges examine each of them in turn.

i. Noncommercial Webcasters have a Lower Willingness to Pay than Commercial Webcasters

A common theme throughout the testimony presented by NRBNMLC is that noncommercial webcasters occupy a distinct market segment from commercial webcasters and have a lower willingness to pay license fees. *See, e.g.*, 8/20/20 Tr. 3255-56 (Cordes); Cordes WDT ¶ 16; Steinberg WDT ¶ 15. NRBNMLC argues that the reason noncommercial webcasters (and nonprofit entities in general) have a lower willingness to pay than their commercial counterparts is the “nondistribution constraint,” *i.e.*, the prohibition under state and federal law on distribution of profits by nonprofit entities. *See* 8/26/20 Tr. 3996 (Steinberg); Steinberg WDT ¶ 14. “[B]ecause profits can’t be distributed, there are no shareholders. The Board of Directors has no financial interest in what the nonprofit does.” 8/26/20 Tr. 3996 (Steinberg). Consequently, “nonprofit organizations are free to pursue charitable missions that are not rewarded in the marketplace.” *Id.*

The nondistribution constraint also limits the financing available to nonprofit entities. “[B]ecause they can’t distribute profits, there’s no access to traditional equity

³³¹ *See supra*, section V.A.1.b.

capital. They can't issue shares of stock that pay dividends.” *Id.* at 3997. The nondistribution constraint “also may pose some challenges to [nonprofits] raising debt capital, because ... it may limit the amount of collateral that they may be able to pledge in exchange for ... debt financing.” 8/20/20 Tr. 3265 (Cordes). Nonprofits are able to receive donations, “[b]ut donations are limited because donations benefit a group of people. It’s a classical public goods problem.” Because of free ridership, “each donor gives less than their willingness to pay in equilibrium.” 8/26/20 Tr. 3998 (Steinberg). For noncommercial broadcasters specifically, FCC rules also limit their ability to raise funds by prohibiting the sale of advertising. *See* Steinberg WDT ¶ 28; *Web IV*, 81 FR at 26319-20. In sum, “the limited access to capital and the fact that ... there are no owners that can ... capture the surplus, those two factors together from an economic perspective would lower the willingness to pay for — on the part of non-commercial broadcasters for license fees.” 8/20/20 Tr. 3265 (Cordes). On this basis, NRBNMLC repeatedly criticizes the existing rate structure for requiring noncommercial webcasters to pay commercial per-performance royalties. *See, e.g.*, NRBNMLC PFFCL ¶ 31.

The Judges have recognized that noncommercial webcasters occupy a distinct submarket within the webcasting market. *See, e.g.*, *Web IV*, 81 FR at 26319-20. For that reason, the Judges adopted the existing rate structure, which provides a substantial discount to noncommercial webcasters. Unlike commercial webcasters, noncommercial webcasters pay *no per-performance royalties* for any transmissions up to the 159,140 monthly ATH threshold. *See* 37 CFR 380.10(a)(2); *see also* SoundExchange Rate Proposal at 3, attach. at 21. A large majority of noncommercial webcasters pay only the annual minimum fee (currently \$500) and pay no per-performance royalties at all. *See* Trial Ex. 5625 ¶¶ 9, 33 (WRT of Travis Ploeger) (Ploeger WRT) (“in 2018, approximately 97% of noncommercial webcasters at the statement of account level (96% at the parent company level) paid only the minimum fee.”). *All* noncommercial

webcasters, regardless of size, benefit from this allowance. *See id.* ¶¶ 35, 37 (in 2018 Family Radio, [REDACTED] religious noncommercial webcasters, received an effective [REDACTED]% discount from commercial webcasting rates and EMF, the noncommercial webcaster [REDACTED], received an effective [REDACTED]% discount). SoundExchange's proposal would increase noncommercial rates (as well as commercial rates), but the discount for noncommercial webcasters would remain at a similar level on a percentage basis. *See id.* ¶¶ 36, 38.

NRBNMLC is not correct in stating that the current rate structure (and SoundExchange's proposal) requires noncommercial webcasters to pay commercial rates. A more accurate statement would be that the current rate structure (and SoundExchange's proposal) requires noncommercial webcasters to pay per-performance royalties on performances over the 159,140 ATH threshold at the same *marginal* rate as commercial webcasters.

NRBNMLC did not examine the question whether noncommercial webcasters' lower willingness to pay requires lower marginal rates as distinguished from lower average rates. The only passing reference to the question was in a colloquy between SoundExchange's expert, Professor Tucker, and the Judges:

Q: As an economist, do you think the more important way to look at this or the more important data point is the marginal rate that's paid per-play or the average rate as you have depicted it?

A: So as an economist, as I was thinking about incentives where, for programming, the marginal rate is going to be hugely important. ... But when I think about the arguments which were proposed by the non-commercial broadcasters about the idea that non-profits deserve a discount, I think this is the right way of looking at it when thinking about the way that they were framing a discount.

* * *

Q: And so do you see that the non-commercial broadcasters would have a marginal decision to make as to whether or not it was worth it to pay the .0028, or whatever the rate would be, per-play based on how much revenue they can anticipate receiving through contributions or whatever donations they could receive as non-commercial broadcasters?

A: You know, so I think as an economist one would have to acknowledge that that would play into their decision-making.

8/17/20 Tr. 2206-07 (Tucker). Professor Tucker's acknowledgement that marginal rates would have an impact on a noncommercial webcaster's decision-making does not persuade the Judges that average rates are unimportant.³³² Nor does it mean that the effective discount for noncommercial webcasters under the current rate structure is meaningless. More importantly, this testimony does not address the question of the appropriate role of marginal rates versus average rates in determining whether a given rate structure exceeds noncommercial webcasters' willingness to pay. NRBNMLC has not adequately developed this argument.

The Judges find, as they have in past proceedings, that noncommercial webcasters constitute a distinct submarket in which they have a lower willingness to pay for licenses than commercial webcasters. However, the Judges are not persuaded that a rate structure in which noncommercial webcasters pay no per-performance fees up to a threshold and commercial per-performance fees above that threshold is inconsistent with that finding.

**ii. In an Unregulated Market Copyright Owners would be willing to
Accept Lower Royalties from Noncommercial Webcasters as a
Form of Price Discrimination**

NRBNMLC argues that the existence of separate submarkets for licensing sound recording performance rights to commercial and noncommercial webcasters fosters seller-side price discrimination that would result in lower royalty rates for

³³² The Judges note, in this regard, that NRBNMLC's Alternative 1 rate proposal also includes a tranche of performances up to an ATH threshold that do not require payment of per-performance royalties, thus lowering the effective average rate for all noncommercial webcasters. Presumably, the NRBNMLC proposal would not include this effective discount if it were meaningless to noncommercial webcasters.

noncommercial webcasters.³³³ See NRBNMLC PFFCL ¶¶ 91-102. Professor Cordes

testified that four conditions must be present for price discrimination to occur:

(a) buyers need to have different price elasticities of demand (sensitivity to higher and lower prices); (b) sellers need to be able to identify which groups of buyers have higher and lower price elasticities of demand; (c) sellers need to have an incentive to differentiate between the price charged to buyers with lower price elasticities and the price charged to buyers with higher price elasticities; and (d) buyers benefiting from the lower prices must not be able to re-sell the good to other buyers.

Cordes WDT ¶ 22. According to Professor Cordes, the hypothetical market for

webcasting services would be “conducive for price discrimination to occur” 8/20/20

Tr. 3266 (Cordes).

Well, first of all, it would be quite easy, obviously, for sellers to be able to identify different segments of the market. You know who the commercial broadcasters are. You know who the non-commercial broadcasters are. So it’s not hard to figure out, you know, which — which group is which. Secondly, because of the distinctive traits of nonprofit broadcasters, they would have a higher price elasticity of demand. They would be more likely to buy the good when they otherwise might not, if, in fact, the price were lowered to them. And, finally, non-commercial broadcasters would be prohibited by regulations from reselling the product.

Id. at 3267.

Even if the Judges were to accept the proposition that record companies would engage in seller-side price discrimination in the hypothetical unregulated market,³³⁴ that

³³³ As relevant here, Professor Cordes defines price discrimination as “the case in which sellers of a good or service are able to segment the market so that they are able to offer the same good or service at different prices to different groups of buyers.” Cordes WDT ¶ 21.

³³⁴ Professor Cordes acknowledged in his written testimony that he did not perform any empirical analysis of the relative price elasticities of commercial and noncommercial webcasters. See Cordes WDT ¶ 24. Nor did he address in his oral testimony the incentives (or disincentives) for record companies to differentiate their prices (the third of his four conditions necessary for price discrimination to occur). For example, the risk of cannibalization, discussed *infra*, section V.B.2.a.iii, could affect record companies’ incentives to engage in price discrimination. These would be relevant considerations in evaluating the strength of Professor Cordes’ proposition concerning price discrimination in the hypothetical market.

does not advance NRBNMLC's attack on the current rate structure and SoundExchange's proposed rate structure. As discussed *supra*, both the existing rate structure and that proposed by SoundExchange provide noncommercial webcasters a substantial discount from the fees charged to commercial webcasters. Professor Cordes' testimony does not address whether price discrimination in the hypothetical market would result in discounts for noncommercial webcasters that would be greater than, less than, or the same as the discount under the current or proposed rates. Nor does it address the particular structure those discounts would take. Nothing in Professor Cordes' testimony concerning price discrimination invalidates or undermines SoundExchange's proposed rate structure.

**iii. Concerns about Cannibalization of Commercial Markets by
Larger Noncommercial Webcasters are Unfounded**

In *Web IV*, the Judges identified the risk of cannibalization as an important consideration in adopting a rate structure that imposes commercial rates for performances by noncommercial webcasters above the 159,140 ATH threshold. *See Web IV*, 81 FR 26392 (“there must be limits to the differential treatment for noncommercial stations to avoid ‘the chance that small noncommercial stations will cannibalize the webcasting market more generally and thereby adversely affect the value of the digital performance right in sound recordings’”) (quoting *Web II*, 72 FR at 24097). NRBNMLC contends “the cannibalization argument is unsupported by the record and unlikely to occur.” Steinberg WDT ¶ 25. NRBNMLC argues that there are a number of differences between commercial and noncommercial entities that make it unlikely listeners will be attracted away from commercial to noncommercial webcasting.

**(A) Noncommercial Broadcasters do not seek to compete with
Commercial Broadcasters**

NRBNMLC contends that, due to the constraints on, and mission-focus of, noncommercial broadcasters, they are averse to competing with commercial entities and

are motivated instead to seek out “unserved markets with respect to their mission.”

8/26/20 Tr. 4008 (Steinberg); *see* Cordes WDT ¶ 16.

The concerns about cannibalization that the Judges articulated in past webcasting proceedings focus on potential displacement in listenership from commercial to noncommercial webcasters and is independent of noncommercial webcasters’ *motivations*. The record shows that at least some noncommercial broadcasters seek to expand their audiences. *See* Emert WDT (*Web IV*) ¶ 38 (“It is obviously not ideal for a noncommercial religious broadcaster to turn listeners away from their programming, as it works against our mission of *reaching as many people as we can* with our message of hope and inspiration ...”) (emphasis added). Whatever the motivation to increase its listenership — whether it be to “compete” or to “advance their mission” — it is the increase in listenership itself that poses a risk of cannibalization if that increase results from diverting listeners who otherwise would be listening to a commercial service. *See* 8/20/20 Tr. 3275-76 (Cordes) (acknowledging that even if a noncommercial webcaster did not set out to compete with commercial webcasters, the noncommercial webcaster could compete with commercial webcasters “simply by growing large because of its popularity.”); *see also* Steinberg WDT ¶ 49 (acknowledging that “it is possible that the cross-price elasticity between the submarkets is negative (indicating some degree of substitutability among listeners),” though opining it is likely to be small due to differences in programming).

Moreover, SoundExchange provided examples of noncommercial webcasters that are in direct competition with commercial webcasters for listeners. Mr. Orszag offered the example of Prazor, a large Internet-only noncommercial webcaster with multiple channels of Christian-themed music, and Sirius XM, a commercial service that carries multiple Christian-themed music channels on its Internet service. *See* Orszag WRT ¶ 159. “It is reasonable that a record company negotiating voluntary licenses with Prazor

and Sirius XM in an unregulated marketplace would be mindful of the potential for competition between them and limit any discount it might be prepared to provide Prazor accordingly.”³³⁵ *Id.* (footnote omitted). In addition, Mr. Orszag testified concerning Salem Media, a large commercial Christian broadcaster, and EMF, a large noncommercial Christian broadcaster, which both have stations in Atlanta that broadcast in the Christian Adult Contemporary (Christian AC) format. *See* Orszag WRT ¶¶ 160-161.

There is clear evidence of competition between Salem and EMF. WFSH is a Salem Christian music station in Atlanta, Georgia broadcasting as 104.7 The Fish and webcasting at <http://thefishatlanta.com/>. WAKL is EMF’s K-Love affiliate in Atlanta. EMF acquired the station from for-profit Cumulus in mid-2019, changed its format from talk to Christian contemporary music, and rebranded it as WAKL. In connection with that acquisition, the press has noted that with those two stations and a third broadcasting in the same format, “Atlanta has suddenly become a hotbed of Christian radio competition,” and the competition included “[a]ll three stations ... simultaneously running aggressive billboard campaigns.”

Id. ¶ 161 (footnote omitted). The Judges find this evidence, albeit anecdotal, casts doubt on “[t]he generalities concerning alleged programming differences that Dr. Steinberg and Dr. Cordes offer” *Id.*

**(B) Noncommercial Broadcasters are Unlikely to Attract Listeners
away from Commercial Broadcasters**

NRBNMLC argues that noncommercial broadcasters’ commitment to mission results in important differences between their on-air programming and that of commercial webcasters. *See* Cordes WDT ¶ 19; 8/20/20 Tr. 3278 (Cordes); 8/31/20 Tr. 4763-64 (Burkhiser). Noncommercial broadcasts include mission-driven nonmusic content, and

³³⁵ NRBNMLC disputes Mr. Orszag’s conclusion, arguing that Prazor’s listenership is too small to constitute a competitive threat to Sirius XM. *See* NRBNLC PFFCL ¶ 211. The Judges agree that, while Mr. Orszag’s example shows that competition between Prazor and Sirius XM is possible, it is *de minimis* at present.

the music content is selected for its congruency with the mission rather than for its popularity with listeners. *See* Cordes WDT ¶ 29; 8/31/20 Tr. 4752-53 (Burkhiser). In addition, NRBNMLC asserts that noncommercial broadcasters pursue different types of listeners than commercial services. Unlike commercial broadcasters, who seek listeners who will increase advertising revenues, noncommercial broadcasters “seek listeners who will best advance their mission.” 8/26/20 Tr. 4007 (Steinberg).

To rebut NRBNMLC’s argument that the programming and audiences for those entities are so different that cannibalization is unlikely, SoundExchange introduced a study prepared by Massarsky Consulting that compared playlist information on commercial and noncommercial radio stations downloaded from Mediabase, a commercial database service that monitors airplay. *See* Ploeger WRT ¶¶ 25-26 app. C. This overlap study compared playlist information from 10 randomly selected commercial Christian AC radio stations with 10 randomly selected noncommercial Christian AC stations during the third quarter of 2019:

[T]he resulting summaries showed that there was an overlapping repertoire of 961 recordings by 259 artists used by both one or more commercial stations and one or more noncommercial stations during the quarter. Those artists represented on both commercial and noncommercial playlists constituted just 49.0% of the artists played on the commercial stations and 74.4% of the artists played on the noncommercial stations, but their recordings were used disproportionately. Thus, plays of recordings by those artists made up 99.0% of the total plays on the commercial stations and 99.4% of the total plays on the noncommercial stations. Similarly, the recordings used on both commercial and noncommercial stations were 52.4% of the recordings played on the commercial stations and 70.5% of the recordings played on the noncommercial stations, but constituted 97.4% of the total plays on the commercial stations and 97.7% of the total plays on the noncommercial stations.

Id. ¶ 25 (footnote omitted).

NRBNMLC argues that this study “suffer[s] from so many flaws as to be meaningless.” NRBNMLC PFFCL ¶ 229. NRBNMLC enumerates several of what it views as flaws:

(1) SoundExchange did not present any Witnesses who were

Familiar with the Design and Execution of the Study

NRBNMLC contends that Mr. Orszag and Mr. Ploeger were unaware of basic information concerning study design, including whether SoundExchange considered including genres other than Christian AC in the study.³³⁶ See NRBNMLC PFFCL ¶¶ 230-231; 9/9/20 Tr. 5845-49 (Ploeger); 8/13/20 Tr. 2019 (Orszag). Nobody from Massarsky Consultant testified.

The Judges find the testimony of Mr. Ploeger and Mr. Orszag, including their testimony on cross-examination, provides a sufficient basis to assess the overlap study and its limitations. As discussed further, *infra*, the overlap study stands for a simple, and fairly limited, proposition: commercial and noncommercial stations broadcasting in the Christian AC format play many of the same songs. Greater detail on the specific decisions that went into the design of the study are unnecessary to evaluate the study's support for that narrow proposition.

³³⁶ Prior to the evidentiary hearing, NRBNMLC sought to exclude the overlap study, together with references to the study in Mr. Ploeger's and Mr. Orszag's testimony, on grounds that Mr. Ploeger, "lacks both (a) the expertise necessary to determine and direct how the study should have been conducted and (b) basic factual knowledge regarding Mediabase, Massarsky Consulting, and the study's design and implementation." NRBNMLC Motion to Strike Written Rebuttal Testimony (WRT) of Travis Ploeger and Jonathan Orszag relating to Mediabase Study, at 3-4 (Mar. 11, 2020). The Judges denied the motion, concluding "the Mediabase playlist database is the type of third-party commercial data source that industry participants rely on and that the Judges have relied upon in past proceedings when presented by lay witnesses." *Order Denying NRBNMLC Motion to Strike*, at 3 (Apr. 2, 2020). The Judges noted, however, that NRBNMLC raised legitimate questions concerning alleged deficiencies in Massarsky Consulting's methodology for selecting the subset of data presented in the study and Mr. Ploeger's alleged lack of knowledge about that methodology. *Id.* The Judges found those alleged deficiencies go to the weight rather than the admissibility of the study. *Id.*

(2) The Study did not Replicate Real-World Behavior of Consumers

NRBNMLC faults the overlap study because it “did not purport ‘to replicate the real world in behavior of consumers.’” NRBNMLC PFFCL ¶ 232 (quoting 8/13/20 Tr. 2039 (Orszag)). NRBNMLC argues, therefore, that the study “cannot be used to infer anything about listener behavior.” NRBNMLC PFFCL ¶ 232.

In the quoted passage from Mr. Orszag’s testimony, he argues against the premise of counsel’s question on cross-examination, explaining the difference between a “study” and an “experiment”:

Q. So I will just ask you—I will ask you a more general question of do you agree with the proposition that litigation experiments need to replicate the marketplace to have external validity in measuring what market participants, you know, might do in that marketplace?

* * *

A. Thank you. So embedded in the words that you asked me in your question are lots of terms that are important for consideration here.

The word “experiment” is very different than the concept of study and different from the concept of analysis.... An experiment, which is trying to replicate the real world in behavior of consumers, is a different question. It’s not something I tackle in this matter.... But nothing that I do here is an experiment.... And nothing in my written direct or written rebuttal testimony in this case involves an experiment.

So your question, thus, becomes difficult for me to answer in any kind of reliable way.

8/13/21 Tr. 2038-39 (Orszag). NRBNMLC has not identified a flaw in the overlap study.

The study was not, and never was intended to be, an experiment. The Judges disagree that the study “cannot be used to infer anything about listener behavior,” however. The study provides information about the songs that commercial and noncommercial religious radio stations transmit in common. That is relevant information from which the Judges can draw inferences about whether listeners to commercial religious stations might listen to noncommercial religious stations, and vice versa.

(3) The Study only Looked at Commercial AC Stations

NRBNMLC criticizes the overlap study for examining playlists only for stations broadcasting in the Christian AC format. *See* NRBNMLC PFFCL ¶ 233. “As such,” according to NRBNMLC, “the study shows nothing about overlap in any other genre.” *Id.*

SoundExchange has explained that it directed Massarsky Consulting to focus on the Christian AC format because that format is responsible for the majority of webcasting royalties from noncommercial stations. *See* Trial Ex. Ploeger WRT ¶ 22 ; 9/9/20 Tr. 5806, 5846 (Ploeger). Because the focus of the inquiry concerning cannibalization is on displacement of listenership, it is logical to examine the portion of the noncommercial webcasting market with the greatest listenership.

NRBNMLC does identify a limitation of the overlap study: that it focuses exclusively on Christian AC stations. That limitation, however, is not accidental—it is by design. Moreover, it is a reasonable design choice and was apparent from Mr. Ploeger’s description of the study. *See* Ploeger WRT ¶ 25.

(4) The Sample of Stations is not Representative

NRBNMLC argues that the pool of Christian AC stations monitored by Mediabase is not representative of the universe of commercial and noncommercial religious stations, *see* NRBMNLC PFFCL ¶ 233 (citing 8/13/20 Tr. 2026 (Orszag)), or even of the universe of Christian AC stations. *See* NRBMNLC PFFCL ¶ 234 (citing Ploeger WRT ¶ 25; 8/13/20 Tr. 2025 (Orszag)). In addition, NRBNMLC contends that the ten commercial and ten noncommercial stations drawn from that pool is also unrepresentative. *See* NRBNMLC PFFCL ¶ 235 (citing 8/13/20 Tr. 2026-28 (Orszag)).

By definition, a pool of stations in a single format is not representative of radio stations as a whole. Mr. Orszag readily agreed to this proposition. *See* 8/13/20 Tr. 2026 (Orszag). As discussed in the previous section, the overlap study’s focus on the format

that is responsible for the majority of webcasting royalties from noncommercial stations was a reasonable design choice.

Mr. Orszag testified that Mediabase monitors only larger stations and, in that sense, the pool of stations in its database is not representative of the broader universe of religious radio stations. *See id.* at 2025 (Orszag). However, Mr. Orszag stated that it was unnecessary to consider the small “mom-and-pop stations” because they do not pay royalties above the minimum fee. *Id.* at 2025-27. Again, the focus on stations with significant listenership that generate significant webcasting royalties is appropriate for the present inquiry.

Regarding NRBNMLC’s contention that the sample of stations selected from the Mediabase database is unrepresentative, Mr. Orszag acknowledged that they are not representative of the larger universe of stations. “By definition, they are going to be larger adult contemporary stations, so basically that means they are not going to be representative of all by definition, they represent the larger ones that qualify to be within the Mediabase data.” 8/13/20 Tr. 2027-28 (Orszag).

The Judges find that the samples drawn from the nonrepresentative collection of Christian AC stations in the Mediabase database are, perforce, not representative of the overall universe of radio stations (or religious radio stations). That limits the extent to which the data derived from that sample can be projected to the broader radio universe. However, the purpose of the present exercise is not to project results to the entire universe of radio stations, but to the much narrower universe of radio stations likely to be subject to per-performance royalties under the current rate structure. The Judges also

note that the sample was selected randomly, which diminishes the possibility of intentional bias.³³⁷

In sum, the Judges find the sample sufficiently representative of the segment of the radio market that is of interest here for the Judges to draw inferences about that market.

(5) Five of the Ten Commercial Stations Examined in the Study are owned by the Same Company

NRBNMLC notes that Salem Media Group owns five of the ten commercial stations covered in the study. NRBNMLC PFFCL ¶ 237. Salem is the leading U.S. commercial Christian broadcaster. *See* Ploeger WRT ¶ 22. NRBNMLC stresses that “Mr. Orszag did ‘nothing to test empirically whether the effect of a single owner owning a big chunk of those stations would bias the analysis.’” *Id.* (quoting 8/13/20 Tr. 2029 (Orszag)). NRBNMLC also points out that only 12 of Salem’s 100 stations broadcast in the Christian AC format. NRBNMLC PFFCL ¶ 237 (citing Trial Ex. 3049).

The fact that a large number of the stations that Massarsky Consulting randomly selected were owned by Salem is unsurprising and reflects Salem’s position as one of the larger players in this market. Moreover, while owned by Salem, Mediabase data reflects that the five stations have distinct (albeit similar) playlists. *See* Ploeger WRT at app. C; Trial Ex. 3040.

³³⁷ NRBNMLC is critical of the fact that Mr. Ploeger, in his deposition, was unable to describe the technical process by which Massarsky Consulting carried out the random selection of stations. *See* NRBNMLC PFFCL ¶ 236. NRBNMLC does not controvert SoundExchange’s assertion that the selection was random, and the Judges accept that assertion. The particular method by which the random selection took place is unimportant.

The fact that a large majority of Salem stations broadcast in other formats is immaterial. By design, the overlap study is limited to Christian AC stations.³³⁸

(6) No Two Stations used in the Study Operate in the Same Market

NRBNMLC argues that, because no two stations used in the study operate in the same market, “listeners to the stations largely would not overlap or pose risk of cannibalization” NRBNMLC PFFCL ¶ 238. The overlap study seeks to demonstrate that commercial and noncommercial stations broadcasting in the Christian AC format play many of the same songs. It does not purport to show the extent of geographic overlap. NRBNMLC’s observation is not relevant. Moreover, it is factually incorrect as applied to webcasting, since any streamed station can be accessed from anywhere in the world regardless of where the broadcast station is located.

(7) The Study Measured the Existence, not the Extent, of Overlap

NRBNMLC observes that “the study counts all plays of a recording as overlapping, as long as a recording is played just one time in one group and at least one time in the other group” 8/13/20 Tr. 2032 (Orszag). NRBNMLC’s suggestion is that the overlap study significantly overstates the degree of playlist overlap between commercial and noncommercial stations.

NRBNMLC’s suggestion is not borne out by the underlying data. Trial Ex.3040 shows the number of “spins” of songs on each station. Some songs that are played frequently on some commercial stations are also played frequently on noncommercial stations. For example, [REDACTED] was played in excess of [REDACTED] times on [REDACTED] of the commercial stations and on [REDACTED] noncommercial stations

³³⁸ See *infra*, section V.B.2.a.iii(B)(3).

[REDACTED]. *See* Trial Ex. 3040. Mr. Ploeger testified that “the recordings used on both commercial and noncommercial stations were 52.4% of the recordings played on the commercial stations and 70.5% of the recordings played on the noncommercial stations, but constituted 97.4% of the total plays on the commercial stations and 97.7% of the total plays on the noncommercial stations.” Ploeger WRT ¶ 25. In light of these statistics and a review of the underlying data, the Judges conclude that the scenario described in NRBNMLC’s observation is very unlikely.

**(8) The Study did not measure Similarities or Differences in
Nonmusic Programming**

NRBNMLC observes that the overlap study did not examine any of the differences or similarities of nonmusic content between commercial and noncommercial stations and argues that it thus ignores important context. *See* NRBNMLC PFFCL ¶ 240. NRBNMLC contends “[t]his is the very ‘context that offers listeners quite different listening experiences and thereby removes the chance that they would be indifferent between the two listening experiences.’” *Id.* (quoting Cordes WDT ¶ 29).

Again, the overlap study seeks to demonstrate that commercial and noncommercial stations broadcasting in the Christian AC format play many of the same songs. It does not purport to show that the listening experience on commercial and noncommercial stations is the same. While information about nonmusic content would have been helpful to the Judges in assessing the risk of cannibalization, its absence does not render the overlap study uninformative.

**(9) SoundExchange did not Conduct a Similar Study to Test
Commercial/Noncommercial Overlap in Music Played on
NPR Stations**

NRBNMLC asserts that “an equally fatal deficiency in the overlap study is that SoundExchange did not conduct a study to test commercial/noncommercial overlap of

any musical genre played on NPR stations.” NRBNMLC PFFCL ¶ 240. NRBNMLC argues that the absence of such a study renders the overlap study “wholly uninformative” as to how NRBNMLC’s benchmark should be adjusted to account for any promotional or substitutional effect. *Id.* ¶ 243.

Once again, NRBNMLC criticizes the overlap study for not doing something it was not designed to do. Moreover, it is NRBNMLC’s burden to show that its benchmark is comparable and to propose adjustments to the extent that it is not. Arguing that the overlap study does not carry that burden for NRBNMLC is not a valid criticism. Finally, NRBNMLC did not advance its benchmark analysis of the NPR agreement until Professor Steinberg’s written *rebuttal* testimony, by which time it was too late for SoundExchange to design and conduct a study. The Judges will not hold SoundExchange’s lack of prescience against it.

(10) The Judges’ Conclusions Regarding the Overlap Study

The Judges find the overlap study to be informative on the question whether commercial and noncommercial stations play many of the same songs. Specifically, the Judges find that the overlap study demonstrates that there is substantial overlap in the music played by commercial and noncommercial stations broadcasting in the format that accounts for most noncommercial royalties. Due to the limitations in the overlap study, the Judges find that it does not support any conclusion as to the specific degree of overlap or whether the overlap actually results in audience diversion. Rather, it supports a conclusion that there is sufficient similarity in the music content of these stations to make diversion a realistic possibility.

(C) Listener Diversion will Increase, not Decrease, Record Company Royalties

NRBNMLC argues that a decrease in the cost of webcasting by noncommercial broadcasters will most likely cause listener diversion from those broadcasters’ over-the-

air broadcasts to their webcasts. *See* NRBNMLC PFFCL ¶ 212. Professor Steinberg testified that “if we make webcasting less costly to stations, they are less likely to limit their webcasting,” permitting more listeners to switch from the broadcast to the webcast. 8/26/20 Tr. 4011-12 (Steinberg). Because webcast plays bear royalties while terrestrial radio plays do not, Professor Steinberg argues that this form of diversion will enhance record company revenue. *See id.* at 4012.

NRBNMLC’s hypothesis concerning the sources and destinations of listener diversion are speculative and unsupported by evidence. Since there is some internal logic to NRBNMLC’s hypothesis, the Judges do not reject it outright, but they accord it little weight.

**iv. Lower License Fees for Noncommercial Broadcasters will Result
in a Net Increase in Record Company Revenue**

NRBNMLC argues that “even with identical products, SoundExchange still would collect – and sound recording copyright owners would receive – the same or greater royalties if the noncommercial market segment were charged a lower per-performance rate due to the additional noncommercial buying activity that would occur.” NRBNMLC PFFCL ¶ 217; *see* Steinberg WDT ¶ 46 (“[W]hen two statutory prices are set, one for each submarket, the price set for commercial webcasters can be the same as the single price, while the [noncommercial webcasters] are charged a lower price and hence buy more licenses. When more licenses are sold, the value of digital performance rights increases.”). This a reprise of the argument concerning price discrimination discussed *supra*, section V.B.2.a.ii.

The Judges find NRBMNLC’s price discrimination argument unpersuasive. NRBNMLC’s economic testimony establishes that one of the conditions necessary for price discrimination to take place in a market is “sellers need to have an incentive to differentiate between the price charged to buyers with lower price elasticities and the

price charged to buyers with higher price elasticities” Cordes WDT ¶ 22. But the NRBNMLC has not demonstrated that such an incentive is present.

The NRBNMLC merely speculates that increased listenership on noncommercial Internet stations will generate more royalties via a diversion of listeners from terrestrial broadcasts than are lost by the diversion of listeners away from commercial Internet radio (*i.e.*, cannibalization). The NRBMNLC proffers no evidentiary support for this speculation, precluding any reliance by the Judges on this argument.

**v. SoundExchange Failed to Provide Empirical Evidence of
Cannibalization**

Ironically, NRBMNLC contends that the record lacks empirical evidence of substantial cannibalization. *See* NRBNMLC PFFCL ¶ 219; Steinberg WDT ¶ 48 (“[T]here is no scientific study in the record demonstrating that cannibalization has ever occurred in this market.”). NRBNMLC notes that several record company witnesses testified that they were unaware of their companies ever having performed such an analysis. *See, e.g.*, 9/3/20 Tr. 5599 (Adadevoh). But there is no reason why SoundExchange should be required to provide evidence regarding cannibalization to support NRBMNLC’s price discrimination argument.

The current rate structure for noncommercial webcasters, which has been in place since 2006, was designed to limit cannibalization of commercial webcasting by noncommercial webcasters. It is unsurprising that no participant has sought to measure the amount of cannibalization in the marketplace. If the rate structure has worked as intended, such a study would be expected to show little if any actual cannibalization. The Judges do not find the absence of empirical evidence of widespread cannibalization to undermine the argument that the *risk* of cannibalization under a different rate structure exists.

**vi. The 2019 NPR/CPB Agreement Demonstrates that Copyright
Owners will License Noncommercial Broadcasters at a Lower
Rate in spite of Fears of Cannibalization**

NRBNMLC argues that SoundExchange’s repeated settlements with NPR/CPB show that record companies are willing to reach agreements with large noncommercial broadcasters “at rates that are significantly lower on average than the current noncommercial rates.” NRBNMLC PFFCL ¶ 244. “If willing record company sellers were genuinely concerned about alleged cannibalization above the threshold from larger noncommercial broadcasters, they would not have agreed to accept lower rates from NPR stations.” *Id.* ¶ 247.

The Judges concluded that NRBNMLC has failed to demonstrate that the 2019 NPR/CPB Agreement is a comparable benchmark. *See infra*, section V.B.1.b. In the absence of a demonstration of comparability, the Judges reject NRBNMLC’s use of that agreement and its predecessors to demonstrate that concerns about cannibalization are unfounded.

**b. Judges’ Conclusions Regarding Reasoning Underlying
SoundExchange Proposed Rate Structure**

NRBNMLC’s counterarguments do not persuade the Judges to reject the rationale for setting rates for above-threshold transmissions equal to commercial rates. The Judges find that there is a risk that large noncommercial webcasters may draw listeners from commercial webcasters and that adopting a rate structure that applies commercial performance rates to above-threshold plays by those larger noncommercial webcasters is appropriate.

3. Adoption of Rate Structure

NRBNMLC relies entirely on the 2019 NPR/CPB Agreement as a benchmark to support its rate proposal.³³⁹ Having rejected use of the 2019 NPR/CPB Agreement as a benchmark,³⁴⁰ the Judges find NRBNMLC's rate proposal unsupported by the evidence and must reject it.³⁴¹

By contrast, the Judges find that the rationale for a continuation of the noncommercial rate structure in place since 2006 remains valid. The Judges, therefore, adopt SoundExchange's proposal for a two-part rate structure under which noncommercial webcasters pay a minimum fee that entitles them to transmit performances of sound recordings up to an ATH threshold and pay commercial, nonsubscription per-performance rates³⁴² for transmissions in excess of that threshold.

Neither SoundExchange nor NRBNMLC proposed that the minimum fee for noncommercial webcasters should differ from the minimum fee for commercial webcasters. The Judges find that noncommercial webcasters should continue to pay the same per station or channel minimum fee as commercial webcasters.³⁴³

While both SoundExchange and NRBNMLC propose the same *average* ATH threshold, SoundExchange proposes retaining the current structure in which the ATH threshold is measured on a monthly basis (159,140 ATH per month), while NRBNMLC

³³⁹ See *supra* note 317 and accompanying text.

³⁴⁰ See *supra*, section V.B.1.

³⁴¹ In light of the Judges' rejection of the NRBNMLC rate proposal, they need not address SoundExchange's contention that they lack authority to adopt NRBNMLC's Alternative 2. See SX PFFCL ¶¶ 1518-1520; *supra*, section V.A.2.c.

³⁴² See *infra*, section IX.C.2.

³⁴³ The Judges set the minimum fee *infra*, section VI.

proposes (in its Alternative 1) that the ATH threshold be measured on an annual basis (1,909,680 ATH per year).³⁴⁴

NRBNMLC contends that annualizing the ATH threshold will “account for seasonal listener peaks and valleys” and “lower transaction costs for both parties” NRBNMLC PFFCL ¶ 158. Professor Steinberg testified that “by doing it on an annual basis, you have lower transactions costs for both parties, and I didn’t see any real reason ... not to do it. I didn’t see any real reason why we shouldn’t save that money.” 8/26/20 Tr. 4040 (Steinberg). NRBNMLC also argues that the NPR agreements support an annualized threshold since they include annual music ATH allotments. *See* NRBNMLC PFFCL ¶ 158.

NRBNMLC offered no evidence — apart from Professor Steinberg’s unsubstantiated assertion — that an annualized ATH threshold would reduce transactions costs. NRBNMLC also offered no explanation why the NPR/CPB settlement agreements — agreements that include *both* an annual payment and an annual ATH allotment — supports a proposal that annualizes only the ATH allotment but retains monthly payments. The Judges find neither argument persuasive.

With regard to levelling out “seasonal peaks and valleys,” NRBNMLC made no case why that is an appropriate or desirable outcome. To be sure, it may well result in lower royalty payments for certain noncommercial webcasters — particularly those that perform large amounts of music with seasonal appeal, such as Christmas music. However, many commercial webcasters also perform large amounts of music with seasonal appeal, increasing the likelihood that noncommercial webcasters will divert listeners from commercial webcasts. Without a more developed argument, supported by evidence, the Judges will not make such a significant change to the method of applying

³⁴⁴ *See supra*, sections V.A.1.a and V.A.2.a.

the ATH threshold to noncommercial webcasters. The ATH threshold shall apply on a monthly basis. Noncommercial webcasters will be subject to per-performance royalties for transmissions in excess of 159,140 ATH in a month.

VI. Minimum Fee

Section 114 of the Copyright Act requires the Judges to determine a minimum fee for each type of service covered by the statutory license. *See* 17 U.S.C. 114(f)(1)(B). Section 112 contains a similar requirement for the statutory license for ephemeral recordings. *See* 17 U.S.C. 112(e)(3)-(4). For the current rate period, the minimum fee for all services is \$500 annually for each station or channel, with an aggregate cap for each commercial webcaster of \$50,000 (*i.e.*, 100 stations or channels).³⁴⁵ *See* 37 CFR 380.10(b). For commercial webcasters, the minimum fee is credited toward per-performance usage fees. *See id.* For noncommercial webcasters, payment of the minimum fee covers usage up to 159,140 Aggregate Tuning Hours (ATH) of audio transmissions. *See id.* § 380.10(a)(1), (b).

For the forthcoming rate period, SoundExchange proposes to increase the minimum fee to \$1,000 annually for each station or channel. *See* SoundExchange's Proposed Rates and Terms at 2 (Sep. 23, 2019) (SoundExchange Rate Proposal). SoundExchange also proposes to increase the aggregate cap for commercial webcasters to \$100,000. *See id.* The Services each propose no change to the current \$500 minimum fee and \$50,000 cap. *See* Google LLC's Proposed Rates and Terms at 2 (Sep. 23, 2019) (Google Rate Proposal); NAB's Proposed Rates and Terms at 8 (Sep. 23, 2019) (NAB Rate Proposal); The NRBNMLC's Amended Proposed Noncommercial Webcaster Rates

³⁴⁵ Five percent of the minimum fee is allocated to ephemeral recordings. *See* 37 CFR 380.10(d).

and Terms, ex. A at 9 (Jul. 31, 2020) (NRBNMLC Rate Proposal);³⁴⁶ and Amended Proposed Rate and Terms of Sirius XM Radio Inc. and Pandora Media, LLC at 1 (Jan. 10, 2020) (Sirius XM Rate Proposal).

A. SoundExchange's Justification for Increasing the Minimum Fee

SoundExchange argues that it is “reasonable and appropriate for the minimum fee at least to cover SoundExchange’s administrative cost.” SX RPFCL (to Services) ¶ 358 (quoting *Digital Performance Right in Sound Recordings and Ephemeral Recordings*, 79 FR 64669, 64672 (Oct. 31, 2014) (*Web II Second Remand*)); see 8/13/20 Tr. 2055 (Orszag) (“it’s important that that minimum fee be set at such a level that is consistent with the cost of processing and dealing with these royalty statements”). SoundExchange contends that its average per station or channel administrative cost more than doubled between 2013 and 2018, increasing from approximately \$1,900 to approximately \$4,448. See Ploeger WRT ¶¶ 13-14; *id.* app. A. ¶ 50 (WDT of Jon Bender) (Bender WDT). According to SoundExchange, increasing the minimum fee from \$500 to \$1000 would ensure that every webcaster contributes reasonably to SoundExchange’s average administrative costs, even if it does not cover them entirely. See Ploeger WRT ¶ 13; Bender WDT ¶ 51.

SoundExchange offers its settlement with CBI as confirmation of the need for an increase in the minimum fee. See SX PPFCL ¶¶ 1554-1556. In that settlement the parties agreed to an increase in the minimum fee, starting at \$550 in 2021 and increasing annually in \$50 increments to \$750 in 2025. See *Determination of Rates and Terms for Digital Performance of Sound Recordings and Making of Ephemeral Copies to Facilitate*

³⁴⁶ The \$500 minimum fee applies only to NRBNMLC’s “Alternative 1” rate proposal. NRBNMLC’s “Alternative 2” employs a flat annual payment that includes minimum fees and usage payments for multiple stations. See NRBNMLC Rate Proposal ex. A at 12.

Those Performances (Web V), 85 FR 12745, 12746 (Mar. 4, 2020) (CBI Settlement).

SoundExchange put forward two reasons why the increase in the CBI Settlement falls short of the 100% increase that it seeks in its rate proposal. “*First*, it avoided the complexities and incremental costs of litigating with a group of webcasters that collectively paid only \$336,800 in statutory royalties (including reporting waiver fees) in 2018.” Ploeger WRT ¶ 15. “*Second*, as a group, the noncommercial educational webcasters covered by the settlement impose lower costs on SoundExchange than other webcasters” because 98% of them pay a \$100 proxy fee that allows them not to file reports of use (thus alleviating SoundExchange of the cost of processing those reports or, if necessary, chasing down delinquent reports). *Id.* ¶ 16.

SoundExchange also contends that the \$500 annual minimum fee has remained the same for more than twenty years, in spite of general increases in the cost of goods and services. *See* Bender WDT ¶ 42; 8/11/20 Tr. 1467 (Orszag). Mr. Orszag testified that using the Consumer Price Index (CPI-U) would be an appropriate, if imperfect, means of measuring the declining purchasing power of the minimum fee compared to the general cost of goods and services. *See* 8/11/20 Tr. 1469-71, 1473-74 (Orszag). Jonathan Bender, SoundExchange’s former CEO, testified that “[a]ccording to the Bureau of Labor Statistics’ CPI inflation calculator, \$500 in October 1998 was equivalent to \$782.19 in August 2019. By the beginning of the next rate period in January 2021, that can reasonably be expected to exceed \$800, and of course it will continue growing during the coming rate period.” Bender WDT ¶ 43. Since prices for services have increased more rapidly than overall prices, SoundExchange contends it is reasonable to expect that its costs of administering the statutory license have increased more rapidly than the CPI-U. *See* 8/11/20 Tr. 1467-68 (Orszag).

SoundExchange notes that the minimum fee has not kept pace with performance royalty rates for webcasting. Mr. Bender testified that the total royalty rate

for nonsubscription commercial webcasters increased 2.36 times between 1998 and 2019.³⁴⁷ “If the minimum fee today were set to cover the same number of performances as contemplated by the Librarian in *Web I*, it would be over \$1180.” Bender WDT ¶ 44. Performing the same calculation using 2006 rates under *Web II* as a starting point would yield a minimum fee of over \$1437 for subscription services. *See id.* ¶ 45.

SoundExchange also seeks to justify an increase in the minimum fee by the generally increasing level of usage.

SoundExchange has observed a marked increase in the average number of performances across all webcasters whose royalties are administered by SoundExchange. We are not aware of a corresponding increase in the average number of channels per webcaster, implying an increase in per channel or station usage. Growth in per channel or station usage means that if minimum fees are to both cover usage and ensure a contribution to the costs of administering the statutory license, minimum fees should go up.

Bender WDT ¶ 52.

In addition, SoundExchange notes that its proposed minimum fees are roughly in line with minimum fees charged for performing musical works by the performing rights organizations (PROs) that represent songwriters and music publishers. SoundExchange asserts that the Judges, and the Librarian before them, used musical works rates “as a check on the reasonableness of the minimum fee under the statutory license.” Bender WDT ¶ 53.

Pursuant to the Judges’ regulations under Section 118 of the Copyright Act, in 2021, the smallest college broadcasting stations will pay \$746 just for use of ASCAP and BMI musical works, plus more if they license musical works through SESAC and Global Music Rights. College broadcasting stations affiliated with large schools will pay \$1,928 for use of ASCAP and BMI musical works. In the case of public broadcasting entities, music format stations in even the smallest markets will pay \$1,639 for use of ASCAP, BMI and SESAC musical works. In large markets the number is \$14,532.

³⁴⁷ Under the *Web I* rate structure, nonsubscription commercial webcasters paid \$0.0007 per performance, plus an additional 8.8% for ephemeral recordings. Mr. Bender used the combined royalty of \$0.0007616 (*i.e.*, 0.0007×1.088) in his calculations. *See* Bender WDT ¶ 44.

As the Judges are well aware, “sound recording rights are paid multiple times the amounts paid for musical works rights” in unregulated markets.

Id. (citations and footnotes omitted).

Finally, SoundExchange contends that its proposed \$100,000 cap on minimum fees for commercial webcasters with more than 100 stations or channels (up from \$50,000 in the current rate period) “is consistent with the minimum fees paid by PSS and SDARS and by new subscription services transmitted through cable and satellite television networks” *Id.* ¶ 54 (citations omitted). SoundExchange avers the change will have a limited impact on commercial webcasters: “In 2018, only 20 webcasters paid the \$50,000 minimum fee and so would presumably pay a \$100,000 minimum fee under SoundExchange’s proposal. Of them, 18 ultimately paid total royalties in excess of \$100,000.” *Id.*

B. The Services’ Response

The Services reject SoundExchange’s effort to justify an increase in minimum fees based on increases in its average administrative cost, arguing that that measure is irrelevant. “The purpose of the minimum fee is to cover SoundExchange’s *incremental* administrative costs, not its *overall administrative costs*.” Services RPFCL ¶ 1536. The Services cite the CARP report and the Librarian’s decision in *Web I* as concurring with this position. *See id.* (citing *Report of the Copyright Arbitration Royalty Panel*, Docket No. 2000-9 CARP DTRA 1&2, at 32, 95 (Feb. 20, 2002) (*Web I CARP Report*); *Determination of Reasonable Rates and Terms for the Digital Performance of Sound Recordings and Ephemeral Recordings*, Final rule and order, Docket No. 2000-9 CARP DTRA 1&2, 67 FR 45240, 45263 (Jul. 8, 2002) (*Web I Determination*)).

The Services draw a contrast between the mechanism for funding SoundExchange’s administration of the section 114 license and the Mechanical Licensing Collective’s (MLC) administration of the section 115 license: Unlike the MLC, which is funded by an assessment on licensees (separate from, and in addition to, usage fees),

SoundExchange's costs are deducted from the royalties it collects. *Compare* 17 U.S.C. 115(d)(7)(A) *with* 17 U.S.C. 114(g)(3). Based on this contrast, the Services conclude that "using the minimum fee to help fund the overall administrative costs of SoundExchange would run afoul of the Act." Services RPFCL ¶ 1536.

The Services also argue that SoundExchange's average cost calculation is flawed. The Services contend that SoundExchange began its calculation with "Total Operating Administrative Expenses" rather than the cost of processing and distributing royalties. *See* Steinberg WRT ¶ 19. The Services argue that "Total Operating Administrative Expenses" covers administration of licenses other than webcasting, and improperly includes "Property and Equipment Depreciation," "Rate-Setting Proceedings Amortization," "Interest expense," and "Tax expense." *See id.*; 9/9/20 Tr. 5863, 5867-74 (Ploeger); Trial Ex. 3023 at 43 (SoundExchange Consolidated Financial Statements, Years Ended December 31, 2018 and 2017). NRBMLC's expert, Professor Steinberg, opined that SoundExchange's estimate of administrative costs is "grossly inflated." Steinberg WRT ¶ 19. The Services also fault SoundExchange for attributing 100 channels to services that actually had more than 100 channels or stations, which the Services contend also inflated SoundExchange's computation of administrative costs on a per-channel basis. Services RPFCL ¶ 1545; *see* 9/9/20 Tr. 5857-58 (Ploeger); Bender WDT ¶ 49.

The Services dispute SoundExchange's assertion that its settlement with CBI confirms the need for an increase in the minimum fee, pointing out that the minimum fee increase in that settlement falls short of the increase that SoundExchange has proposed. *See* Services RPFCL ¶ 1554. The Services argue that the minimum fee in the CBI agreement is, "if anything, too high for broader application" because CBI had more to gain by settling than SoundExchange. Steinberg WDT ¶ 31. While the Services acknowledge SoundExchange's explanation that a lower minimum fee is justified for

CBI members because they impose lower costs on SoundExchange than do other services, the Services point out that the same rationale could apply to all commercial and noncommercial webcasters that pay only the minimum fee. *See* Services RPFCL ¶ 1554. The Services opine that “SoundExchange could decrease those costs further by deciding to waive reports of use for ... noncommercial webcasters also webcasting at or below 80,000 monthly ATH.” *Id.*

The Services dispute SoundExchange’s argument that inflation over the past twenty years justifies a minimum fee increase. First, the Services deny that the current minimum fee has been in place that long, since the minimum fee under *Web I* was applied per licensee, not per station or channel. *See id.* ¶ 1557; 8/13/20 Tr. 2015 (Orszag). Second, the Services contend that “SoundExchange agreed to \$500 for 2020,” in *Web IV*, “so that year, not 1998, is the year from which to consider changes.” Services RPFCL ¶ 1558. Moreover, notwithstanding the general rate of inflation, the Services suggest that SoundExchange’s processing costs have decreased over time due to increasing use of automation. *See id.* ¶ 1559; *see also* Bender WDT ¶¶ 9-10; 8/11/20 Tr. 1470 (Orszag).

Regarding SoundExchange’s argument that the minimum fee has not kept pace with per-performance rates, the Services point out that the Judges have stated that the minimum fee “is meant to cover administrative costs” and “does not address actual usage.” *Web II*, 72 FR at 24099.

The Services describe SoundExchange’s arguments based on rates for use of musical works as “improper.” Services RPFCL ¶ 1564-1565. The Services note that SoundExchange has long opposed, and the Judges have long rejected, use of musical works fees for setting sound recording rates. *See, e.g., Web II*, 72 FR at 24092-95; *see also* Bender WDT ¶ 53 & n.16 (“the use of musical work rates to set sound recording rates has otherwise been thoroughly rejected, which SoundExchange believes is proper”).

In addition, the Services argue that the rates cited by SoundExchange are not comparable because they are flat fees covering unlimited broadcasting rather than minimum fees. *See* Services RPFCL ¶ 1564-1565 (citing 37 CFR 381.5(c)). The Services also note differences in the structure of the market for licensing musical works (*i.e.*, multiple collecting societies with mutually exclusive repertoires versus a single collective covering the entire industry), as well as differing administrative costs at the level of each individual collecting society. *See* Steinberg WRT ¶ 20.

Finally, the Services reject SoundExchange's reference to minimum fees for PSS and SDARS to justify increasing the cap on minimum fees for commercial webcasters, stating that the other statutory licenses are "not applicable here." Services RPFCL ¶ 1566.

C. The Judges' Findings and Conclusions Regarding the Minimum Fee

SoundExchange offers six measures by which it argues that the current \$500 minimum fee should increase: SoundExchange's average administrative cost, the minimum fee agreed to by SoundExchange and CBI, inflation, per-performance sound recording royalty rates, usage, and minimum fees charged for broadcasting of musical works. The Services' reject each of these measures (or SoundExchange's application of them) for various reasons. Instead, they offer two possible measures for adjusting the minimum fee: SoundExchange's incremental administrative costs and anticipated inflation between 2020 and 2025.

1. Increased Average Administrative Cost since 2013 Supports Increasing the Minimum Fee

a. Use of Incremental versus Average Administrative Costs

The Judges and their predecessors have never determined that the minimum fee under section 114 exists solely to cover SoundExchange's incremental administrative

costs. To be sure, the Services have made that argument consistently since *Web I*.

However, the Judges and their predecessors have never embraced it.

In *Web I*, for example, the CARP concurred with the Services that

one purpose of the minimum fee is to protect against a situation in which the licensee's performances are such that it costs the license administrator more to administer the license than it would receive in royalties. Another arguable purpose is to capture the intrinsic value of a service's *access* to the full blanket license, irrespective of whether the service actually transmits any performances.

Web I CARP Report at 95. The CARP did not find that the minimum fee existed solely to cover incremental costs, access value, or both.

In his review of the *Web I CARP Report*, the Librarian stated “the Panel could propose any rate consistent with the agreements so long as the proposed rate would cover costs for administering the license *and access to the works*.”³⁴⁸ *Web I Determination*, 67 FR at 45263 (emphasis added). Whether the CARP and the Librarian were referring to average or incremental costs of administering the license, it is clear that both agreed that covering those costs was only *one* purpose for the minimum fee.

As the Services acknowledge, in later decisions the Judges routinely referred to the minimum fee as covering SoundExchange’s “administrative cost” or “average administrative cost,” rather than SoundExchange’s incremental cost of administering the license. *See, e.g., Web II*, 72 FR at 24096; *Web III*, 79 FR at 23124; and *Web IV*, 81 FR at 26396-97.

³⁴⁸ The minimum fee selected by the CARP was the lowest minimum fee found in the benchmarks put before the panel. *See id.* The CARP reasoned that a “sophisticated and experienced negotiator ... would not negotiate a minimum fee that would expose it to a loss.” *Id.*

The Services point out, correctly, that the Librarian referred to “the incremental cost of licensing” in a separate passage. *See Services RPFCL* ¶ 1536. Elsewhere, including the passage quoted in the text, the Librarian refers merely to “costs for administering the license.”

The Services are unable to point to relevant statutory language or legislative history that supports their position. While the Copyright Act itself is silent as to the purpose of the minimum fee, legislative history instructs that “[a] minimum fee should ensure that copyright owners are fairly compensated in the event that other methodologies for setting rates might deny copyright owners an adequate royalty.” H.R. Rep. No. 105-796, at 85 (1998) (*DMCA Conference Report*). The *DMCA Conference Report* plainly does not limit a minimum fee merely to covering incremental costs of administering the license. Covering incremental costs is one element of ensuring that copyright owners are “fairly compensated,” but it is not the only element. Covering incremental costs is the bare minimum that a minimum fee must accomplish.

The Judges find the Service’s argument contrasting the funding mechanism for SoundExchange with the funding mechanism for the Mechanical Licensing Collective to be inapt. The minimum fee is not an assessment, over and above royalties, that funds SoundExchange’s operations. For commercial webcasters, the minimum fee is credited against usage. For noncommercial webcasters, the minimum fee includes a substantial quantity of usage. While there are webcasters whose usage falls below the amount that is covered by the minimum fee, that is simply inherent in the nature of any minimum fee. The fact that some webcasters do not recoup the entire value of the minimum fee does not convert it into an administrative assessment.

There is little testimony in the record on the subject of whether, from an economic standpoint, it is preferable to refer to incremental or average costs in setting the minimum fee. The following colloquy between Mr. Orszag and the Judges is on point:

Q: Mr. Orszag, you mentioned a couple of times that you look at average cost, not incremental I’m equating that with marginal cost. But doesn’t economics, basic economic principles [counsel] ... that pricing should equal marginal cost if it’s otherwise competitive?

A: But pricing in those discussions also say that we need to ensure that the pricing covers costs as well, because if everyone got marginal cost pricing,

then it could be the situation where everyone is getting a low price but they're not actually covering the cost to administer the service.

* * *

Q: Are you saying—are you saying this is a declining cost of business for SoundExchange so the marginal cost is below average cost at the—at the level of production?

A: I—I would assume that to be the case here. If [you] add one new licensee, the cost of adding that one licensee is far below the cost of the first licensee. And so we need to—one would need to ensure that the—the total costs are covered so that the service can actually be provided in that circumstance.

8/12/20 Tr. 1760-61 (Orszag). Mr. Orszag's unrebutted testimony supports setting the minimum fee with reference to SoundExchange's average administrative cost.

The Judges, consistent with prior determinations, conclude that they may consider SoundExchange's average administrative cost in setting the minimum fee.

b. Computation of Average Administrative Cost

Professor Steinberg testified that SoundExchange's computation of administrative costs was flawed because it “does not distinguish between administrative costs attributable to licensing and processing fees from other administrative costs associated with running any modern corporation.” Steinberg WRT ¶ 19. The Services contend that SoundExchange improperly included in its calculation of average administrative costs a number of items unrelated to license administration, such as property and equipment depreciation, interest and tax expenses, and amortization of the cost of participating in rate-setting proceedings. *See id.*; Services RPFCL ¶ 1545.

This aspect of Professor Steinberg's testimony follows from the Service's position that the function of the minimum fee is to cover SoundExchange's incremental cost of licensing. Given the Judges' conclusion that they may consider SoundExchange's average administrative cost in establishing a minimum fee, the Judges accord it no weight.

Similarly, the Judges do not find SoundExchange's inclusion of costs related to the administration of licenses other than the webcasting license to be improper given that the Judges will consider SoundExchange's average administrative cost. SoundExchange has computed that average by dividing its total administrative costs by its total number of licensees (webcasting and non-webcasting), then dividing that quotient by the estimated number of channels or stations per licensee. *See* Bender WDT ¶¶ 48-50; 9/9/20 Tr. 5893 (Ploeger). That is an appropriate means of determining SoundExchange's average administrative cost per channel or station.

Finally, the Judges do not find SoundExchange's estimation of the number of channels or stations per licensee to be improper. In deriving that estimate, SoundExchange attributed 100 channels or stations to licensees that had more than 100 channels or stations. The existing and proposed minimum fee structure caps minimum fees for commercial webcasters at 100 times the per-channel or station minimum fee. SoundExchange's methodology thus divides per-licensee administrative costs over the average number of channels or stations *for which licensees pay the minimum fee*.³⁴⁹ *See* Bender WDT ¶ 49. The Judges find that it is appropriate to limit consideration to channels or stations for which licensees pay the minimum fee, given that the purpose of the calculation is to find a basis for setting that minimum fee.

The Judges find SoundExchange's calculation of its average administrative cost on a per-channel or station basis to be acceptable. The Judges are mindful that, because it is based on an estimation of the number of channels or stations per licensee, it is itself an estimate rather than a precise quantification.

³⁴⁹ While the regulations do not cap minimum fees for noncommercial licensees, no noncommercial licensee has more than 100 channels or stations. *See* Ploeger WRT ¶ 9 n.2.

**c. Judges' Conclusions Concerning Increased Average Administrative
Cost as a Basis for Increasing the Minimum Fee**

The record reflects that SoundExchange's estimate of its average administrative cost on a per-channel or station basis increased from approximately \$1,900 to approximately \$4,448 between 2013 and 2018, an increase of 2.34 times. *See* Ploeger WRT ¶¶ 13-14; Bender WDT ¶ 50. While both are estimates, SoundExchange calculated both using the same methodology.

The absolute amount of SoundExchange's estimated average administrative cost exceeds SoundExchange's proposed minimum fee by a significant amount. The relative increase in average administrative costs (134%, which would yield a minimum fee of \$1170) also exceeds the relative increase in the minimum fee that SoundExchange is seeking (100%, yielding a minimum fee of \$1000). The Judges conclude that the evidence relating to SoundExchange's average administrative cost supports the increased minimum fee that SoundExchange has proposed.

**2. SoundExchange's Settlement with CBI Supports Increasing the
Minimum Fee**

SoundExchange and CBI agreed to a gradual increase in the minimum fee to \$750 by 2025. This increase is materially different from that proposed by SoundExchange, both in its magnitude and its gradual implementation. Nevertheless, SoundExchange offers it as confirmation of the need for an increase in the minimum fee and offers two explanations for the difference between the agreement and the proposed minimum fee: litigation savings and a lower cost for processing usage statements from CBI members. *See* SX PFFCL ¶¶ 1554-1556 (and record citations therein).

On the existing record, the Judges cannot accept SoundExchange's first explanation. As the Services point out, both parties saved litigation costs by settling, and

it is entirely possible that the litigation savings were of equal or greater value to CBI than SoundExchange.

SoundExchange's second explanation is a stronger justification for the lower increase. The Judges reject the Services' counterargument that other low usage webcasters would have similarly low processing costs if they, like the noncommercial educational webcasters covered by the CBI agreement, were permitted to pay a proxy fee and thus avoid submitting reports of use. *See Services RPFCL ¶ 1554.* They are not permitted to do that. The Judges will not assume away a cost that SoundExchange bears, based on the Services' counterfactual.

The Judges conclude that the CBI agreement is evidence that willing buyers and willing sellers would agree to a minimum fee that exceeds the existing minimum fee. The unique circumstances of the CBI agreement may indicate that the increase agreed to in that settlement may be toward the low end of reasonable minimum fees. However, given the indeterminacy of the effect of litigation costs on the parties' relative bargaining positions, the Judges find that they cannot derive a specific minimum fee amount from that settlement.

3. General Inflation since 2006 Supports an Increased Minimum Fee

SoundExchange argues that increases in the general level of prices while the \$500 minimum fee has been in effect, as measured by the CPI-U, is another justification for increasing the minimum fee. The Services appear to acknowledge inflation as a justification for increasing the minimum fee, although they would have the Judges look only to prospective inflation from 2020 to 2025 because "SoundExchange agreed to \$500 for 2020" in its *Web IV* rate proposal. *Services RPFCL ¶ 1558.*

The Judges reject the Services' argument that the current \$500 minimum fee is a willing buyer / willing seller rate because SoundExchange and the Services both proposed that amount in *Web IV*. The current minimum fee was determined by the

Judges and imposed as part of the regulatory scheme. SoundExchange's rate proposal was a position taken in a regulatory proceeding, not the action of a willing seller in a market unconstrained by a statutory license.

The Judges also reject SoundExchange's contention that the appropriate starting point for calculating inflation is 1998. The *Web I* minimum fee was calculated per licensee, not per channel or station. *See* 8/13/20 Tr. 2015 (Orszag). It was not the same fee that the Judges adopted for the *Web II* rate period, beginning in 2006, that was assessed on a per-channel or station basis. The current \$500 annual per-channel or station minimum fee has been in place since 2006; 2006 is the appropriate base year for any inflation calculation.

According to the Bureau for Labor Statistics, the CPI-U for January 2006 was 198.3, and the CPI-U for December 2020 was 260.474.³⁵⁰ That represents a 31.35% increase. Consequently, to have the equivalent purchasing power of the minimum fee in 2006, the current minimum fee would need to increase to \$656.77.

The Judges recognize that general inflationary data are an imperfect substitute in this context for data concerning changes to SoundExchange's actual costs. Nevertheless, the Judges find that the increase in inflation over the period from 2006 to the end of 2020 reflects an erosion in the purchasing power of the minimum fee that supports an increase, though not necessarily the doubling that SoundExchange seeks.

4. Other Justifications for Increasing the Minimum Fee

The Judges reject SoundExchange's additional justifications for increasing the minimum fee: increased royalty rates, increased usage, and failure to keep pace with

³⁵⁰ *See Historical Consumer Price Index for All Urban Consumers (CPI-U): U.S. city average, all items, by month*, <https://www.bls.gov/cpi/tables/supplemental-files/historical-cpi-u-202101.pdf> (last visited May 24, 2021). The Judges take official notice of these publicly available government data.

minimum fees for public performance of musical works. While the minimum fee is recoupable against charges for usage, it is not a usage fee as such. SoundExchange has provided no reasoned explanation why the minimum fee should be tied to the royalty rates or the amount of usage, and the Judges see no reason, *a priori*, that it should be.

Regarding the minimum fees charged by PROs for public performance of musical works, the Judges (at SoundExchange's urging) have long rejected use of musical works rates in setting sound recording rates. *See, e.g., Web II*, 72 FR at 24092-95; Bender WDT ¶ 53 & n.16. The Judges see no reason to make an exception for the minimum fee.

5. Conclusion

The three justifications offered by SoundExchange and accepted by the Judges suggest a range of minimum fees from \$656.77 at the low end to \$1170 at the high end. The Judges find this range to represent the zone of reasonable minimum fees supported by the record in this proceeding.

Of the three accepted justifications, the Judges find the increase in SoundExchange's average administrative cost to be the most compelling. Unlike the inflation approach, average administrative cost relates directly to actual costs incurred by SoundExchange. Unlike the minimum fee agreed to by SoundExchange and CBI, the average administrative cost does not suffer from the indeterminacy of the relative savings in litigation costs achieved by the parties to the settlement. The Judges recognize that the average administrative cost put forward by SoundExchange is an estimate since it incorporates SoundExchange's estimate of the average number of channels or stations per licensee. Consequently, the Judges regard the 134% increase in average administrative costs, and the \$1170 minimum fee it implies, as an upper limit on a reasonable minimum fee. Nevertheless, since the Judges find the average administrative cost approach to be the most compelling, the Judges find that the minimum fee should be set closer to this upper limit than to the lower limit (set using the rate of inflation).

SoundExchange's proposed \$1000 minimum fee falls comfortably within the zone of reasonable minimum fees determined by the Judges and falls closer to the high end of that range. The Judges, therefore, adopt SoundExchange's proposed \$1000 per-channel or station minimum fee for the forthcoming rate period. The Judges also adopt SoundExchange's proposal to increase the cap on minimum fees for commercial webcasters to \$100,000, in effect retaining the existing 100 channel or station cap for each commercial licensee. The Judges deem this adjustment to be arithmetically necessary because failure to increase the cap would negate the increase in the minimum fee for the largest webcasters (who would effectively pay the same amount on half as many channels).

VII. Ephemeral License Rate and Terms

Section 112 of the Copyright Act creates a statutory license to make phonorecords to facilitate the transmission of sound recordings under the section 114(f) statutory license and requires the Judges to determine reasonable rates and terms of royalty payments for making those so-called "ephemeral recordings." 17 U.S.C. 112(e). During the current rate period, the royalty for ephemeral recordings is part of the total royalty for webcasting and constitutes 5% of that amount. 37 CFR 380.10(d).

SoundExchange proposes that the Judges retain the current royalty rate and rate structure for ephemeral recordings in the forthcoming rate period with some "clarifying editorial changes" to the relevant regulatory terms. SX PFFCL ¶ 1568; *see* SoundExchange's Proposed Rates and Terms at 3, 22 (Sep. 23, 2019) (SoundExchange Rate Proposal). Most of the Services propose to retain the existing provision on ephemeral recordings. *See* Sirius XM and Pandora First Amended Proposed Rates and Terms at 1 (proposing that the current terms continue except as otherwise indicated); Google Proposed Rates and Terms at 1; NAB Proposed Rates and Terms at 9; NRBNMLC Amended Proposed Rates and Terms ex. A at 9 (Alternative 1). In its

Alternative 2 rate proposal, NRBNMLC includes the same editorial changes that SoundExchange proposes. *See* NRBNMLC Amended Proposed Rates and Terms ex. A at 12 (Alternative 2). The Services do not dispute SoundExchange’s proposal to adopt 37 CFR 380.10(d) with the editorial changes SoundExchange and NRBNMLC propose.³⁵¹ *See* Services RPFCL ¶¶ 1576-1577.

As in *Web IV*, SoundExchange relies on the designated testimony of economist Dr. George Ford from *Web III*. *See* Trial Ex. 5616 (Designated WDT of George Ford) (Ford Des. WDT); *Web IV*, 81 FR at 26397-98. Dr. Ford testified that “it is typical for ephemeral copy rights to be expressly included among the grant of rights provided” in marketplace agreements between record companies and music services. Ford Des. WDT at 11. “Most of these agreements do not set a distinct rate for those ephemeral copies, incorporating them instead into the overall rate that the [music services] pay[] for the combined ephemeral copy rights and performance rights.” *Id.* at 11-12. Dr. Ford also testified that to the extent marketplace agreements do set a royalty rate for ephemeral recordings they generally express that rate as a percentage of an overall bundled rate for both performances and ephemerals. *See* Ford Des. WDT at 12-14.

³⁵¹ SoundExchange and the Services are generally on the same page regarding ephemeral recordings, except as to the question whether the right to make ephemeral recordings has independent economic value. *Compare* SX PFFCL ¶ 1570 (and sources cited therein) (“ephemeral copies have economic value to services that publicly perform sound recordings because these services cannot, as a practical matter, properly function without those copies”) *with* Services RPFCL ¶ 1570 (and sources cited therein) (“While the Services do not dispute that ephemeral recording right is frequently needed, it does not have independent economic value.”). The Judges need not (and do not) resolve this largely academic question to determine an ephemeral recordings rate.

SoundExchange also offers several direct licenses in the record of this proceeding as evidence that marketplace agreements do not set distinct rates (as distinguished from bundled rates) for ephemeral recordings. *See, e.g.*, Trial Ex. 4035 at 11-12, 16-19 (2015 agreement between [REDACTED] and [REDACTED] granting [REDACTED]); Trial Ex. 5037 at 3-4, 5-9 (2017 agreement between [REDACTED] and [REDACTED] granting [REDACTED]).

As to the specific allocation of royalties between the performance and ephemeral recording rights, SoundExchange notes that this allocation has no effect on the Services. *See* SX PFFCL ¶ 1574. Rather, the real interested parties in determining the allocation are record companies and performing artists because payments under section 114 are subject to a mandatory division between artists and record companies and payments under section 112 are not. *See id.*; Ford Des. WDT at 13-14; 17 U.S.C. 114(g)(2). “Because the willing buyer” (*i.e.*, the music service) “is disinterested with respect to that allocation, the agreement between the record companies and the artists thereby becomes the best indication of the proper allocation of royalties.” Ford Des. WDT at 14. Dr. Ford testified to the existence of an agreement between artists and record companies that 5% of royalties should be allocated to the ephemeral recordings right and 95% should be allocated to the performance right. *See id.* at 15. Mr. Bender testified that the SoundExchange board of directors, which is comprised of record company and performing artist representatives, “adopted a resolution reflecting agreement that 5% of the royalties for the bundle of rights should be attributable to the Section 112(e) ephemeral royalties, with the rest being allocated to the Section 114 performance royalties.” Bender WDT ¶ 56. SoundExchange avers that “[a]s a result, a 95%-5% split ‘credibly represents the result that would in fact obtain in a hypothetical marketplace

negotiation between a willing buyer and the interested willing sellers under the relevant constraints.” SX PFFCL ¶ 1575 (quoting Ford Des. WDT at 15).³⁵²

SoundExchange states that the editorial changes it seeks to 37 CFR 380.10(d) more “clearly state[] the effect of the 95%-5% split,” and opines that “[t]his change will not have any effect other than making the current rule clearer.” SX PFFCL ¶ 1576. SoundExchange notes that the change is consistent with NRBNMLC’s Alternative 2 proposal and with SoundExchange’s settlements with CBI and NPR/CPB. *See id.* ¶¶ 1568, 1577.

The Judges find the testimony and agreements that SoundExchange cites in its proposed findings to be persuasive as to both the inclusion of ephemeral recordings royalties within a bundled rate for performances and ephemerals and the specific allocation of 5% of the bundled royalty to the section 112(e) license. The Judges also find SoundExchange’s proposed editorial changes to be appropriate and supported by the record. The Judges, therefore, adopt SoundExchange’s proposals regarding ephemeral recordings in their entirety.

VIII. Terms

One of the purposes of this proceeding is to establish terms for the administration of the rates the Judges determine for the rate period 2021 to 2025. The parties proposed adoption of certain terms to be included in Subchapter E of Chapter III, title 37 CFR. The Judges have weighed the proposals and the arguments of the parties in support of or opposed to various regulatory provisions and adopt the Terms as detailed in “Exhibit A”

³⁵² The SoundExchange Board resolution reflecting the agreement between artists and copyright owners is not in the record. Dr. Ford’s and Mr. Bender’s testimony concerning the agreement, therefore, is hearsay. The Judges exercise their discretion under 37 CFR 351.10(a) to admit and consider this hearsay testimony.

to this determination. The parties' proposals, and the Judges' rulings, include the following³⁵³.

A. Standards for the Adoption of Terms and Other Regulatory Language

The Judges' employ the willing buyer/willing seller standard to establish terms for the administration of royalty rates. 17 U.S.C. 114(f)(1)(B); *Web II*, 72 FR at 24102. SoundExchange offers that the Judges have an obligation to adopt terms that will facilitate an efficient collection, distribution, and administration of the statutory royalties. SX PFFCL ¶ 1578 (citing *Web II*, 72 FR at 24102); *see also SDARS II*, 78 FR at 23073. The Judges clarify that decisions to adopt terms, while informed by policy considerations, such as those suggested by SoundExchange, are ultimately guided by record evidence. Rulemaking proceedings are the proper avenue for consideration of several of the terms requested in this proceeding. As is addressed below, the Judges have a pending rulemaking proceeding in which they may address several such proposals.

SoundExchange also argues for consistency of terms with those applicable to satellite radio and preexisting services. SX PFFCL ¶¶ 1579-1583. The Services counter that the standard the Judges must apply regarding proposed terms is the willing buyer/willing seller standard. Services RPFCL ¶¶ 1579-1583. As stated above, the Judges' decision regarding terms is informed by such considerations but is guided ultimately by the willing buyer/willing seller standard. As SoundExchange acknowledges, the market for webcasting is different from other services, and different rates and terms apply. In addition, evidence differs across proceedings. As a general matter, the Judges seek consistency across the regulatory provisions administering rates,

³⁵³ The Judges also adopt several of the proposed changes that are merely technical, structural, or conforming amendments to the regulations.

to the extent consistency is warranted or permitted by the specific facts of individual rate proceedings.

B. Designating SoundExchange as the Collective

The Judges designate SoundExchange as the Collective under this Determination. SoundExchange participated in this proceeding as the existing and presumed Collective. SoundExchange proposed to continue as the Collective. *See* SoundExchange Proposed Rates and Terms at 12. No party objected to SoundExchange continuing in the role of Collective. The Judges acknowledge the administrative and technological knowledge base developed by SoundExchange over its years of service as the Collective. Finding sufficient basis, in the entirety of the record, for SoundExchange to serve, the Judges re-designate SoundExchange to serve as the Collective for purposes of collecting, monitoring, managing, and distributing sound recording royalties established by part 380 of the Judges' regulations.

C. Audit Terms

There are several issues presented in this proceeding regarding the audit provisions. The more persuasive evidence points to resolution of most of the issues in favor of continuing to apply the existing terms. The record contains evidence of a number of contracts that have substantially similar audit provisions to such regulations. The audit provisions are addressed below.

1. Late Fee for Late Payments Discovered in Audits

The Services propose a separate interest rate for late payments resulting from underpayments discovered in audits. The Services propose a fee for audit-discovered late payments that is lower than the prevailing 1.5% late fee. Specifically, the Services propose the interest rate for preexisting subscription services and satellite radio

services,³⁵⁴ which looks to the federal post-judgment rate in 28 U.S.C. 1961. Services PFFCL ¶¶ 328-330; Second Amended Proposed Rates and Terms of Sirius XM Radio Inc. and Pandora Media at 2; NAB Proposed Rates and Terms at 6; Google Proposed Rates and Terms at 3; NRBNMLC’s Amended Proposed Rates and Terms ex. A at 6. SoundExchange counters, in part, that the current context differs from PSS/SDARS. SX PFFCL ¶¶ 1593-1601. The Judges agree that the context differs, but that is not the determining factor. As addressed below, the contract terms negotiated by willing buyers and willing sellers, in evidence from similar markets, are persuasive.

Both the Services and SoundExchange make arguments about good faith and bad faith on the part of stakeholders in the context of audit-discovered late payments. SX PFFCL ¶¶ 1605-1609; Services PFFCL ¶ 329. The Judges find insufficient evidence in the record to suggest that any actor, in this context, is or has been significantly motivated by, or acted in, bad faith. Such matters, if confronted, may be adequately addressed by the re-adoption of other requirements in the existing audit provision, such as those requiring reasonableness, the use of a Qualified Auditor, and actions being in accordance with generally accepted auditing standards. As for the arguments over whether the late fee, applied to all late payments, is a hardship, the Judges make no judgment either way. Such late fees in exemplary contracts demonstrate that willing parties have agreed to such terms, even if they may at times function as a hardship. *See, e.g.*, Trial Ex. 4035 at 20, 28; Trial Ex. 5111 at 24, 34. Relatedly, the Services put forth an argument that applying a general late fee rate to audit-discovered late payments is unnecessarily “punitive.” Services RPFCL ¶¶ 1617-1618. The Judges find that differences between a reasonable late fee being viewed as alternatively punitive or motivating are largely semantics. Indeed, the Services recognize that in its original context, the general late fee of 1.5%

³⁵⁴ *See* 37 CFR 382.7(g).

monthly interest rate plainly serves as a short-term penalty to incentivize timely payment. Services PFFCL ¶ 330. Based on the entirety of the record, the Judges find a late fee, applicable across all late payments, motivates compliance, as it should.

Specifically, several contract terms negotiated by willing buyers and willing sellers on matters such as this one serve as reliable evidence. *See, e.g.*, Trial Ex. 5013 at 80; Trial Ex. 5037 at 69 (regarding “late payments discovered in audit”). The Judges find that the contracts in evidence indicate sufficient and persuasive instances in which willing buyers and willing sellers negotiated that the same late fee rate exists for any late payments, without separate treatment of underpayments discovered in an audit. *Id.* The Judges therefore conclude that the designated late fees will apply to any late payments, [REDACTED] the underpayments are discovered in audits.

The Judges re-adopt the monthly late fee of 1.5 percent. The Judges observe that in admitted contracts, there is a range from [REDACTED] up to [REDACTED]%. *See, e.g.*, Trial Ex. 2013 ([REDACTED]); Trial Ex. 4035 at 20, 28 ([REDACTED]%); Trial Ex. 5013 at 38, 80 ([REDACTED]%); Trial Ex. 5074 at 2 ([REDACTED]%), 5037 at 68-69 ([REDACTED]%). The 1.5% rate is an accepted rate in the market. For this reason, the Judges adopt it as the generally applicable late fee, and reject the Services’ proposed change.

2. Frequency of Audits

SoundExchange proposes adoption of a provision regarding frequency of audits that would allow it to conduct multiple audits of a licensee in parallel, with each audit covering a different period of time. Specifically, SoundExchange proposes a change to reflect that the payor’s payments for a particular year may be audited only once, rather than that a licensee may be audited only once a year. SoundExchange suggests a need for such a provision by offering evidence of various delays in recent audits. It also notes that its proposal is similar in effect to the statutory provision concerning audits of services

licensed under the section 115 blanket license. SX PFFCL ¶¶ 1619-1622. The Services dispute that delays in audit processing are attributable to licensees or that licensees may benefit from prolonging the audit process. Services RPFCL ¶¶ 1620-1621. The Services indicate that several of the Services' benchmark agreements limit the frequency of audits. Services RPFCL ¶ 1622; *see*, e.g., Trial Ex. 5013 at 79; Trial Ex. 5037 at 69 (regarding "audit" no more than once per calendar year). The Judges are informed by the terms in negotiated contracts addressing the frequency of audits, cited by the Services and otherwise — namely, those that limit audits of a payor's or licensee's payments to once per year. The Judges find that such evidence, and the record as a whole, does not support SoundExchange's proposal to allow an audit of a payor or licensee more than once in any year. The Judges, therefore, reject SoundExchange's proposal.

3. Audit Deadlines and Audit Fee Shifting

SoundExchange proposes response deadlines within audits, alleging various delays in past audit processes. SX PFFCL ¶¶ 1623-1630. SoundExchange also proposes that the costs of an audit be shifted to the licensee if the auditor is not provided requested information that is in the possession of the licensee or its contractor within 60 days after a written request therefor, again, referring to various alleged delays in past audit processes. SX PFFCL ¶¶ 1631-1642. The Services dispute the causes and nature of the alleged delays and offer that there is a lack of record evidence to support the SoundExchange proposals. Services PFFCL ¶¶ 1623-1642. Sirius XM, Pandora, and NAB propose what they characterize as a much more effective solution than the SoundExchange proposal, which is to require that audits be completed within one year of being noticed. Services PFFCL ¶¶ 341-346. The Judges find that the record does not provide persuasive evidence that either side's proposals would be negotiated by willing buyers and willing sellers. The Judges do not adopt the proposed deadlines or fee shifting. The Judges are persuaded that the existing, and broadly re-proposed, provisions requiring

reasonableness, the use of a Qualified Auditor, and actions being in accordance with generally accepted auditing standards, adequately address the concerns regarding delays. At the same time, these existing provisions are persuasively supported by record evidence, such as relevant contracts negotiated by willing buyers and willing sellers. *See, e.g.,* Trial Ex. 5013 at 70-80. Trial Ex. 5037 at 69 (regarding [REDACTED]).

4. Auditor's Right to Consult Its Client

SoundExchange requests terms clarifying that an auditor may consult with its client throughout the audit process, including to advise the client concerning the status of the audit, request information from the client relevant to the audit, and request the client's views concerning tentative findings and other issues. In support of this proposal, SoundExchange points to alleged impediments to efficient completion of audits that may be alleviated by its request. SX PFFCL ¶¶ 1643-1655. The Services oppose this requested provision, alleging that it would disrupt the proper independence of an auditor. Services PFFCL ¶¶ 353-356; Services RPPFCL ¶¶ 1623-1642. The Judges find that the record does not provide persuasive evidence that SoundExchange's proposals would be negotiated by willing buyers and willing sellers. The Judges do not adopt the proposed provisions allowing auditors broad consultation with its client. The Judges are persuaded that the existing, and re-proposed, provisions requiring the use of a Qualified Auditor and actions being in accordance with generally accepted auditing standards appropriately address the scope of client and third-party-auditor consultations. At the same time, these existing provisions are persuasively supported by record evidence, such as relevant contracts negotiated by willing buyers and willing sellers. *See, e.g.,* Trial Ex. 5013 at 79; Trial Ex. 5037 at 69 (regarding [REDACTED]).

5. Credit for Overpayment

Sirius XM/Pandora and NAB propose that the Judges specify that the amount of any overpayment discovered in an audit may be deducted from the next payment(s) due.

Services PFFCL ¶¶ 333-334; Sirius XM and Pandora First Amended Proposed Rates and Terms at 2; NAB Proposed Rates and Terms at 6. Sirius XM, Pandora, NAB, and the NRBNMLC suggest that the proposal is a matter of basic fairness and is in line with regulations issued by the Copyright Office related to the audit of statements of account under the statutory licenses in secs. 111 and 115. Services PFFCL ¶¶ 335-338.

SoundExchange, in its opposition to this proposal, submits that it is unnecessary, as isolated overpayments in an audit are rare, and such overpayments have been offset by larger underpayments. SoundExchange adds that the proposal is administratively burdensome, noting that the money may not be recoupable once it is paid to artists. SX PFFCL ¶¶ 1656-1660. On the balance of the record, the Judges are in agreement with SoundExchange. In addition, in this context, the burden of submitting accurate payments is on the licensee, and the licensee bears the risk of overpayment. Therefore, the Judges do not adopt this proposal.

6. “Net” Underpayments

Under existing regulations, SoundExchange must bear the costs of audits that it requests unless the auditor determines that there was an underpayment of 10% or more, in which case the service being audited pays the reasonable cost of the audit. 37 CFR 380.6(h). NAB and the NRBNMLC seek to clarify that the costs of an audit shifted to a service only in the case of a *net* underpayment (*i.e.* underpayments less any overpayments) of 10% or more. NAB, through its witness, Tres Williams, offered the view that the clarification better reflects practices in the marketplace. Services PFFCL ¶ 339 (citing Williams WDT ¶ 42). The Judges are persuaded by the entirety of the record, including the testimony of Mr. Williams and relevant marketplace contracts in the record, that the proposal is representative of practices negotiated by willing buyers and willing sellers in the marketplace. *See, e.g.*, Trial Ex. 5013 at 80; Trial Ex. 5037 at 69 (regarding [REDACTED]). The Judges, therefore, adopt the proposal.

D. Statements of Account Showing Recoupment of Minimum Fees

SoundExchange proposes that even services that pay the minimum fee be required to file statements of account and reports of use. It urges that such reporting would pose a minimal burden on licensees and would promote timely and accurate calculation of minimum fee recoupment. SoundExchange avers that, in the absence of statements of account showing recoupment of minimum fees, SoundExchange frequently finds itself inquiring of licensees concerning missing statements of account, only to be told that the licensee's usage to date is covered by a minimum fee payment. SX PFFCL ¶¶ 1664-1666. The Services oppose any requirement to report usage when royalties are not due, noting that licensees already are required to certify their statements of account on an annual basis. The Services also indicate that the proposed change would be unnecessary and burdensome. Services RPPFCL ¶¶ 1664-1666. The Judges appreciate the desire to ensure the accuracy of payments, including minimum payments. However, the Judges note that the record contains little useful evidence regarding how licensees in this category would address such reports in a willing buyer/willing seller context. Additionally the Judges observe that goals of the requested provision may be addressed through revisions to the Reports of Use provisions in 37 CFR 370. A related rulemaking is pending, and the Judges intend to refresh the record on the subjects of that rulemaking. *See* Docket No. 14-CRB-0005 RM.

E. Account Numbers and Reporting of ISRCs

SoundExchange proposes requirements for the use of account numbers on payments, statements of accounts, and reports of use. SXPFFCL ¶¶ 1667-1670. The Services do not oppose SoundExchange on this matter. Services RPPFCL ¶¶ 1667-1670. The Judges find the proposal a reasonable and appropriate means of improving the efficiency of processing payments, statements of account, and reports of use and, therefore, adopt the proposal.

SoundExchange proposes a provision requiring licensees to use International Standard Recording Codes (ISRCs) in their reports of use, where available and feasible, notwithstanding 37 CFR 370.4(d)(2)(v). SoundExchange expresses concern that the current regulations addressing reports of use are not sufficient to identify unambiguously which recordings a service used. SX PFFCL ¶¶ 1671-1678. The Services point to the rulemaking that may address the use of ISRCs and suggest that it would be inappropriate to shift onto the Services the effort of gathering such information, which the Services often do not have complete access to and which originates with SoundExchange's own members in the first instance. Services RPFCL ¶¶ 1671-1678. The Judges note that the record contains little useful evidence regarding how licensees would address such a requirement in a willing buyer/willing seller context. Additionally the Judges observe that goals of the requested provision may be addressed through the Reports of Use provisions in 37 CFR 370. A related rulemaking is pending, and the Judges intend to refresh the record on the subjects of that rulemaking. *See* Docket No. 14-CRB-0005 RM.

F. Reporting Usage of Directly Licensed Tracks

SoundExchange proposes adopting a provision requiring reporting of directly-licensed sound recordings excluded from royalty calculations. It offers that similar provisions have proven helpful for identifying potential payment errors and disputes relating to the classification of recordings as directly licensed. SX PFFCL ¶¶ 1679-1684. The Services submit that SoundExchange has not pointed to evidence of any instance of significant errors in categorizing directly-licensed tracks, nor has it indicated that its ability to audit a webcaster would not be sufficient to allow it to address any such errors. They add that SoundExchange does not require this information to distribute royalties that are paid to it under the statutory license and that, in some instances, licensees are bound by confidentiality provisions preventing such disclosure. Services RPFCL ¶¶ 1679-1684. The Judges find that the record, including the instances of negotiated

agreements regarding holding such direct license information confidential, is persuasive evidence for not adopting the requested provision. The Judges, therefore, do not adopt the proposal.

G. Unclaimed Funds

SoundExchange proposes that if it is unable, for a period of three years, to identify or locate a copyright owner or performer who is entitled to receive a royalty distribution, it may apply such “unclaimed funds” to offset any costs deductible under 17 U.S.C. 114(g)(3), as it was permitted to do prior to *Web IV*. It points to the Music Modernization Act (MMA) and the new provisions in sections 115(d)(3)(J)(i)-(ii) and 114(g)(7) as a signal from Congress that the Judges are authorized to preempt state property law claims to unclaimed funds. It urges that the Judges need not, and should not, direct SoundExchange to act in accordance with applicable federal, state, or common law with regard to such funds. SX PFFCL ¶¶ 1685-1694. The Services oppose SoundExchange’s request, pointing out that it would allow SoundExchange to spend the unclaimed funds on legislative and litigation expenses and potentially profit from the use of such funds. They further note that if SoundExchange is authorized to use unclaimed funds to offset its administrative costs, it may undermine the Collective’s case regarding minimum fees. Services RPFCL ¶¶ 1692-1693. Sirius XM and Pandora oppose the requested provision for similar reasons and go on to dispute the application of section 115(d)(3)(J)(i)-(ii) to the request. Sirius XM and Pandora request that the Judges require that any unclaimed funds be distributed among copyright owners based on usage data, instead of providing a windfall to SoundExchange. Pandora/Sirius XM PFFCL ¶¶ 250-252.

The Judges agree with Sirius XM and Pandora that the provisions of sec. 115 are not applicable to the current proposal. The Judges also accept SoundExchange’s arguments that the new section 114(g)(7) authorizes regulations that preempt state law

and are persuaded that the MMA provision expresses a policy choice favoring such preemption. On the entirety of current record, the Judges are not convinced that the unclaimed funds should be distributed among copyright owners based on usage data. The Judges are persuaded that the more appropriate path (and the path that is consistent with intent of Congress) is to allow the Collective (*i.e.*, SoundExchange), after three years,³⁵⁵ to apply unclaimed funds against administrative expenses, thus reducing the burden of administrative expenses that must be borne by copyright owners and performing artists.

H. Proxy Distribution for Missing Reports of Use

SoundExchange proposes a provision to allow the use of proxy data to distribute royalties in certain circumstances in which adequate reports of use are not available. SX PFFCL ¶¶ 1695-1705. The Judges are not persuaded by SoundExchange’s arguments or evidence in favor of the particular proposal to allow proxy distribution. The Judges observe that SoundExchange points to prior authorizations allowing proxy distributions which were granted through rulemaking authority as opposed to determinations of rates and terms. The Judges also observe SoundExchange’s citations to the new provisions of section 114(g)(7). The Judges again note the pending rulemaking and the Judges’ intent to refresh the record on the subjects of that rulemaking. *See* Docket No. 14-CRB-0005 RM.

I. Definition of Performance

Google proposes that the Judges delete text from definition of Performance setting out that an example of a performance is “the delivery of any portion of a single

³⁵⁵ The proposed three-year period is not in dispute. *See* 17 U.S.C. 507(b). The three-year period for the unclaimed funds term (in then § 260.7) was adopted on June 18, 2003, and remains based in the statute, 17 U.S.C. 507(b). *See* 68 Fed. Reg. 36469.

track from a compact disc to one listener.” Google Proposed Rates and Terms at 3.

SoundExchange opposes deletion of the text, urging that the entirety of the definition is necessary to know what the sound recording unit is that must be counted, especially for particular types of recordings such as Classical music tracks. SX PFFCL ¶¶ 1706-1709.

The entirety of the record is persuasive to the Judges that the entirety of the definition should be maintained. The Judges, therefore, reject Google’s proposal.

IX. Royalty Rates Determined by the Judges

A. Annual Price Level Adjustments to Statutory Royalty Rates

In *Web IV*, the Judges set statutory rates for the first year of the rate term (2016) and specified that the rates would be adjusted annually for the remainder of the rate term to reflect cumulative changes in the CPI-U from a base level set in November 2015. *See Web IV*, 81 FR at 26404; 37 CFR 380.10(c). The Judges effectively broke with their practice in *Web II* and *Web III* of specifying annual increases, relying on Professor Shapiro’s *Web IV* testimony that “a regulatory provision requiring an annual price level adjustment is preferable to an implicit or explicit prediction of future inflation (or deflation).” *Web IV*, 81 FR at 26404. With the exception of the NAB, all of the participants’ rate proposals would continue the practice established in *Web IV* of making annual price level adjustments based on the CPI-U. *See* SoundExchange Rate Proposal at 2-3; Sirius XM and Pandora Second Amended Proposed Rates and Terms at 1; Google Proposed Rates and Terms at 4; NRBNMLC Amended Proposed Rates and Terms ex. A at 9 (Alternative 1).

The NAB opposes price level increases to the statutory rates. *See* NAB PFFCL ¶¶ 207-208. The NAB bases its proposal to eliminate price level increases on a discussion in Dr. Leonard’s written testimony:

[A]s an economic matter, any yearly increase in the statutory rate should be tied to the increase in prices in a narrower industry—*e.g.*, music services and the royalties paid by such services. Prices in other industries reflected in the CPI *may* be driven by economic factors that play no role in the music

industry. Conversely music prices *may* be driven by economic factors that play no role in other industries. For either reason the general CPI *may* have low correlation with prices in the music industry.

Leonard WDT ¶ 119 (emphasis added). Dr. Leonard then argues that a review of prices in the music industry “suggests little, if any, change in recent years.” *Id.* ¶ 120. Dr. Leonard notes that the retail price for subscription streaming services has remained the same or declined over the past several years, implying that per subscriber royalties (which are generally calculated as a percentage of the subscription price) have also stayed constant or declined. *See id.* He also states that “the per-play royalty for sound recording rights for ad-supported Spotify was lower in the first quarter of 2019 as compared to 2018.” *Id.*

The NAB states that SoundExchange’s proposal is based on testimony from Mr. Orszag that assumes “that revenue can be expected to increase over time at least at the rate of inflation.” NAB PFFCL ¶ 208 (quoting Orszag WDT ¶ 82 n.118). The NAB argues that Mr. Orszag “did not distinguish between subscription and advertising revenues, did not analyze whether services’ revenues per-play have actually increased at the rate of inflation, and did not analyze whether simulcasters revenues per simulcast play have actually increased at the rate of inflation.” *Id.*

In support of inflation-based price level increases, SoundExchange cites testimony from Professor Shapiro and Mr. Orszag supporting inflation-indexed rates. *See* SX RPFCL (to NAB) ¶ 208 (citing Shapiro WDT at 4; Orszag WRT ¶ 138; Peterson WDT ¶ 14 (“The recommended per-play rate could be escalated for inflation as measured by the consumer price index (CPI).”); Willig WDT ¶ 55 (deriving average rates for five-year period, then using discount rate equal to rate of inflation to compute 2021 rate)).

SoundExchange argues that Professor Leonard’s analysis of pricing is inadequate because of its reliance on subscription pricing in a market that is dominated by ad-supported services, and because his perception of the trend for effective per-play royalty

rates for ad supported services is based on inadequate data. *See* SX RPFCL (to NAB) ¶ 207. As to the latter point, SoundExchange also refers to Mr. Orszag’s testimony that advertising prices are a more relevant metric and have increased faster than the CPI. *See id.* (citing Orszag WRT ¶ 137).

Finally, SoundExchange argues that “there is no basis for singling out simulcasters for a special analysis of inflationary trends,” noting that the NAB bears the burden of demonstrating that simulcasters are entitled to a differentiated rate.

The Judges find Dr. Leonard’s testimony concerning price level adjustments unpersuasive. Dr. Leonard’s statements concerning the difference between general inflation and inflation in the music industry (*e.g.*, “the general CPI *may* have low correlation with prices in the music industry”) is both tentative and poorly supported by the market evidence he analyzes. In this regard, the Judges agree with the critique lodged by SoundExchange and Mr. Orszag. *See* SX RPFCL (to NAB) ¶ 207; Orszag WRT ¶ 137.

More critically, the NAB fails to provide persuasive evidence to support its proposal that statutory royalty rates should remain at the same level throughout the rate term for all types of services. That proposal contains an implicit assumption that price levels will remain the same across the music industry over the next five years. That is hardly self-evident. In the absence of persuasive evidence that prices will remain static across the entire music industry for the next five years, the Judges will not presume that to be the case. The NAB has not presented such persuasive evidence.³⁵⁶

³⁵⁶ If the NAB had presented evidence of some other index that it demonstrated was more closely aligned with price changes in the music services, the Judges could have considered such an index as an alternative to the CPI-U. However, the NAB did not present such evidence, leaving the Judges with a choice between a five-year freeze on the statutory rates or an extension tied to a reasonable index. The Judges find that

The Judges find a price level adjustment based on changes to the CPI-U to be supported by the testimony of economists who testified on behalf of SoundExchange and the Services. Moreover, the Judges find changes in the CPI-U to be a reasonable proxy for measuring changes in price levels in the relevant industries.³⁵⁷

Consequently, the Judges will set statutory rates for the year 2021 and index those rates for inflation over the remainder of the rate term using 2020 as the base year. Specifically, for the years 2022 through 2025, the rates shall be adjusted to reflect any inflation or deflation, as measured by changes in the Consumer Price Index for All Urban Consumers (U.S. City Average, all items) (CPI-U) announced by BLS in November of the immediately preceding year, as described in the regulations set forth in this Determination.

B. Minimum Fee

In accordance with the Judges' analysis, *supra*, section VI.C, the annual minimum fee applicable to commercial webcasters shall be **\$1000 per channel or station**, subject to an annual cap of \$100,000 per licensee. The minimum fee shall be non-refundable, but shall be credited against usage fees.

The annual minimum fee applicable to noncommercial webcasters (other than those covered by SoundExchange's settlements with CBI and NPR/CPB), shall be **\$1000**

rates adjusted based on the CPI-U are clearly preferable to rates that are frozen arbitrarily for the duration of the five-year rate term.

³⁵⁷ The Judges note that when rates in a voluntary settlement must be extended beyond the term of a settlement to cover the period of a statutory rate term, Congress has instructed the Judges to adjust those rates "to reflect national monetary inflation during the additional period the rates remain in effect." 17 U.S.C. 805. The Judges view this as support for the proposition that national inflation rates are a reasonable proxy for price changes in the relevant industries.

per channel or station. The minimum fee shall be non-refundable, and shall cover usage up to 159,140 ATH per month.

C. Commercial Rates

1. Commercial Subscription Rates

In accordance with the Judges’ analysis *supra*, section IV, the royalty rate for noninteractive subscription services is **\$0.0026 per play**. In computing this rate, the Judges take note that Professor Shapiro and Mr. Orszag agree that the benchmark rate needs to be adjusted to reflect the actual increase in the CPI-U for 2020 because the economic data on which they rely is current only into 2019. *See* Shapiro WDT at 2 (recommending 2019 as the applicable base year to measure price level changes in 2020); Orszag WDT ¶ 82 n.118. (requesting that the Judges follow their procedure in the prior webcasting rate proceeding, *see Web IV*, 81 FR at 26405, where the Judges adjusted a steering-based benchmark rate to reflect actual inflation in the year prior to the first year of the new rate period (*i.e.*, 2015 for the 2016-2020 rate period)). Applying this approach, the Judges note that in 2020, the CPI-U increased by 1.4%. <https://www.bls.gov/opub/ted/2021/consumer-price-index-2020-in-review.htm> (accessed June 10, 2021). Applying a 1.4% adjustment to the \$0.0026 rate increases the rate to \$0.0026364 which, when rounded, remains at \$0.0026 for 2021.³⁵⁸

³⁵⁸ The \$0.0026 rate is also supported by the Judges’ finding that Professor Willig’s Shapley Model-derived rates serve only as *limited guideposts*, indicating that *effectively competitive* rates generated via a Shapley Value Model would be less than \$0.0028 per play for subscription services. When “the Judges are confronted with evidence that, standing alone, is not itself wholly sufficient, they may rely on that evidence “to *guide* the determination,” *i.e.*, by using it as a “*guide post*” when considering the application of more compelling evidence. *SDARS II*, 78 FR at 23063, 23066 (emphasis added).

2. Commercial Nonsubscription Rates

Having found the weighted consideration of Mr. Orszag's and Professor Shapiro's benchmark model analyses for the ad-supported market yielded a rate of \$0.0023 per play, and Dr. Peterson's benchmark model analysis for the ad-supported market yielded a rate of \$0.0021 per play, the Judges conclude that the more granular, label-specific, analysis and application of adjustments to account for funneling/conversion in Dr. Peterson's benchmark analysis lends greater weight to the \$0.0021 per-play rate. The Judges apply the same methodology for adjusting this ad-supported rate as they applied in the immediately preceding paragraph for the subscription rate, and for the same reasons. Here too, the 1.4% increase in the CPI-U does not increase the statutory rate set by the Judges, *i.e.*, it increases the rate to \$0.0021294 which, when rounded, remains at \$0.0021.³⁵⁹ The Judges note that this conclusion is also supported by the limited guideposts yielded by Professor Willig's Shapley Model-derived rates, as adjusted by the Judges, which indicate that effectively competitive rates would be less than \$0.0023 for ad-supported services. For these reasons, and in accordance with the Judges' analysis *supra*, section IV, the royalty rate for ad-supported, or commercial nonsubscription, services is **\$0.0021 per play**.

3. Ephemeral Recording Rate

In accordance with the Judges' analysis *supra*, section VII, the royalty rate for ephemeral recordings under 17 U.S.C. 112(e) applicable to commercial webcasters shall be included within, and constitute **5%** of, the royalties such webcasters pay for performances of sound recordings under section 114 of the Act.

³⁵⁹ No other party that addressed the ad-supported rate issue objected to the Judges making the same CPI-U adjustment, to bring older economic data more current, as the Judges did in *Web IV*.

D. Noncommercial Rates

1. NPR-CPB/SoundExchange Settlement

The Judges have previously adopted the settlement agreement between SoundExchange, on one hand, and National Public Radio and the Corporation for Public Broadcasting, on the other, for simulcast transmissions by public radio stations. *See Digital Performance Right in Sound Recordings and Ephemeral Recordings, Final Rule*, 85 FR 11857 (Feb. 28, 2020). The rates and terms governing transmissions and ephemeral recordings by the entities that are covered by that settlement agreement for the period 2021-2025 shall be as set forth in the agreement and codified at 37 CFR 380.30-380.32 (subpart D).

2. CBI/SoundExchange Settlement

The Judges have previously adopted the settlement agreement between SoundExchange, and College Broadcasters, Inc., for transmissions by Noncommercial Educational Webcasters (NEWs). *See Digital Performance Right in Sound Recordings and Ephemeral Recordings, Final Rule*, 85 FR 12745 (Mar. 4, 2020). The rates and terms governing transmissions and ephemeral recordings by NEWs for the period 2021-2025 shall be as set forth in the agreement and codified at 37 CFR 380.20-380.22 (subpart C).

3. All Other Noncommercial Webcasters

In accordance with the Judges' analysis *supra*, section V.B, the royalty rate for webcast transmissions by all other noncommercial webcasters during the 2021-2025 rate period shall be **\$1000 annually for each station or channel** for all webcast transmissions totaling not more than 159,140 Aggregate Tuning Hours (ATH) in a month, for each year in the rate term. In addition, if, in any month, a noncommercial webcaster makes total transmissions in excess of 159,140 ATH on any individual channel or station, the noncommercial webcaster shall pay per-performance royalty fees for the

transmissions it makes on that channel or station in excess of 159,140 ATH at the rate of **\$0.0021 per performance**, as adjusted annually upward or downward to reflect changes in the CPI-U from the CPI-U published by BLS in November 2020.

4. Ephemeral Recording Rate

The royalty rate for ephemeral recordings under 17 U.S.C. 112(e) applicable to noncommercial webcasters shall be the same as the rate applicable to commercial webcasters; that is, royalties for ephemeral recordings shall be included within, and constitute **5%** of, the royalties such webcasters pay for performances of sound recordings under section 114 of the Act.

X. Conclusion

On the basis of the foregoing, the Judges propound the rates and terms described in this Determination. No participant having filed a timely petition for rehearing, the Judges have made no substantive alterations to the body of the Initial Determination. However, in accordance with the Judges' *Order Granting Motion to Conform Regulations to Determination* (Jun. 30, 2021), the Judges have modified the regulatory provisions in Exhibit A to add provisions concerning the use of account numbers that had been omitted from the provisions attached to the Initial Determination as the result of a clerical error. In addition, the Judges have corrected a clerical error in the heading to section VIII.E, *supra*, and various typographical, grammatical, citation, and punctuation errors throughout the Determination. The Register of Copyrights may review the Judges' Determination for legal error in resolving a material issue of substantive law under title 17, United States Code. The Librarian shall cause the Judges' Determination, and any correction thereto by the Register, to be published in the Federal Register no later than the conclusion of the 60-day review period.

Jesse M. Feder
Chief Copyright Royalty Judge.

Steve Ruwe

Copyright Royalty Judge.

David R. Strickler
Copyright Royalty Judge.

Dated: July 22, 2021

List of Subjects in 37 CFR Part 380

Copyright, Sound recordings.

Final Regulations

In consideration of the foregoing, the Copyright Royalty Judges amend part 380 of title 37 of the Code of Federal Regulations as follows:

PART 380— RATES AND TERMS FOR TRANSMISSIONS BY ELIGIBLE NONSUBSCRIPTION SERVICES AND NEW SUBSCRIPTION SERVICES AND FOR THE MAKING OF EPHEMERAL REPRODUCTIONS TO FACILITATE THOSE TRANSMISSIONS

1. The authority citation for part 380 continues to read as follows:

Authority: 17 U.S.C. 112(e), 114(f), 804(b)(3).

2. Revise subpart A to read as follows:

Subpart A—Regulations of General Application

Sec.

380.1 Scope and compliance.

380.2 Making payment of royalty fees.

380.3 Delivering statements of account.

380.4 Distributing royalty fees.

380.5 Handling Confidential Information.

380.6 Auditing payments and distributions.

380.7 Definitions.

§ 380.1 Scope and compliance.

(a) *Scope.* Subparts A and B of this part codify rates and terms of royalty payments for the public performance of sound recordings in certain digital transmissions

by certain Licensees in accordance with the applicable provisions of 17 U.S.C. 114 and for the making of Ephemeral Recordings by those Licensees in accordance with the provisions of 17 U.S.C. 112(e), during the period January 1, 2021, through December 31, 2025.

(b) *Limited application of terms and definitions.* The terms and definitions in subpart A of this part apply only to subpart B of this part, except as expressly adopted and applied in subpart C or subpart D of this part.

(c) *Legal compliance.* Licensees relying upon the statutory licenses set forth in 17 U.S.C. 112(e) and 114 must comply with the requirements of this part and any other applicable regulations.

(d) *Voluntary agreements.* Notwithstanding the royalty rates and terms established in any subparts of this part, the rates and terms of any license agreements entered into by Copyright Owners and Licensees may apply in lieu of these rates and terms.

§ 380.2 Making payment of royalty fees.

(a) *Payment to the Collective.* A Licensee must make the royalty payments due under this part to SoundExchange, Inc., which is the Collective designated by the Copyright Royalty Board to collect and distribute royalties under this part.

(b) *Monthly payments.* A Licensee must make royalty payments on a monthly basis. Payments are due on or before the 45th day after the end of the month in which the Licensee made Eligible Transmissions.

(c) *Minimum payments.* A Licensee must make any minimum annual payments due under subpart B of this part by January 31 of the applicable license year. A Licensee that as of January 31 of any year has not made any eligible nonsubscription transmissions, noninteractive digital audio transmissions as part of a new subscription service, or Ephemeral Recordings pursuant to the licenses in 17 U.S.C. 114 and/or 17 U.S.C. 112(e), but that begins making such transmissions after that date must make any

payment due by the 45th day after the end of the month in which the Licensee commences making such transmissions.

(d) *Late fees.* A Licensee must pay a late fee for each payment and each Statement of Account that the Collective receives after the due date. The late fee is 1.5% (or the highest lawful rate, whichever is lower) of the late payment amount per month. The late fee for a late Statement of Account is 1.5% of the payment amount associated with the Statement of Account. Late fees accrue from the due date until the date that the Collective receives the late payment or late Statement of Account.

(1) *Waiver of late fees.* The Collective may waive or lower late fees for immaterial or inadvertent failures of a Licensee to make a timely payment or submit a timely Statement of Account.

(2) *Notice regarding noncompliant Statements of Account.* If it is reasonably evident to the Collective that a timely-provided Statement of Account is materially noncompliant, the Collective must notify the Licensee within 90 days of discovery of the noncompliance.

(e) *Use of account numbers.* If the Collective notifies a Licensee of an account number to be used to identify its royalty payments for a particular service offering, the Licensee must include that account number on its check or check stub for any payment for that service offering made by check, in the identifying information for any payment for that service offering made by electronic transfer, in its statements of account for that service offering under § 380.4, and in the transmittal of its Reports of Use for that service offering under § 370.4 of this chapter.

§ 380.3 Delivering statements of account.

(a) *Statements of Account.* Any payment due under this part must be accompanied by a corresponding Statement of Account that must contain the following information:

(1) Such information as is necessary to calculate the accompanying royalty payment;

(2) The name, address, business title, telephone number, facsimile number (if any), electronic mail address (if any) and other contact information of the person to be contacted for information or questions concerning the content of the Statement of Account;

(3) The account number assigned to the Licensee by the Collective for the relevant service offering (if the Licensee has been notified of such account number by the Collective);

(4) The signature of:

(i) The Licensee or a duly authorized agent of Licensee;

(ii) A partner or delegate if the Licensee is a partnership; or

(iii) An officer of the corporation if the Licensee is a corporation.

(5) The printed or typewritten name of the person signing the Statement of Account;

(6) If the Licensee is a partnership or corporation, the title or official position held in the partnership or corporation by the person signing the Statement of Account;

(7) A certification of the capacity of the person signing;

(8) The date of signature; and

(9) An attestation to the following effect: I, the undersigned owner/officer/partner/agent of the Licensee have examined this Statement of Account and hereby state that it is true, accurate, and complete to my knowledge after reasonable due diligence and that it fairly presents, in all material respects, the liabilities of the Licensee pursuant to 17 U.S.C. 112(e) and 114 and applicable regulations adopted under those sections.

(b) *Certification.* Licensee's Chief Financial Officer or, if Licensee does not have a Chief Financial Officer, a person authorized to sign Statements of Account for the Licensee must submit a signed certification on an annual basis attesting that Licensee's royalty statements for the prior year represent a true and accurate determination of the royalties due and that any method of allocation employed by Licensee was applied in good faith and in accordance with U.S. GAAP.

§ 380.4 Distributing royalty fees.

(a) *Distribution of royalties.* (1) The Collective must promptly distribute royalties received from Licensees to Copyright Owners and Performers that are entitled thereto, or to their designated agents. The Collective shall only be responsible for making distributions to those who provide the Collective with information as is necessary to identify and pay the correct recipient. The Collective must distribute royalties on a basis that values all performances by a Licensee equally based upon the information provided under the Reports of Use requirements for Licensees pursuant to § 370.4 of this chapter and this subpart.

(2) The Collective must use its best efforts to identify and locate copyright owners and featured artists in order to distribute royalties payable to them under sec. 112(e) or 114(d)(2) of title 17, United States Code, or both. Such efforts must include, but not be limited to, searches in Copyright Office public records and published directories of sound recording copyright owners.

(b) *Unclaimed funds.* If the Collective is unable to identify or locate a Copyright Owner or Performer who is entitled to receive a royalty distribution under this part, the Collective must retain the required payment in a segregated trust account for a period of three years from the date of the first distribution of royalties from the relevant payment by a Licensee. No claim to distribution shall be valid after the expiration of the three-year

period. After expiration of this period, the Collective may apply the unclaimed funds to offset any costs deductible under 17 U.S.C. 114(g)(3).

(c) *Retention of records.* Licensees and the Collective shall keep books and records relating to payments and distributions of royalties for a period of not less than the prior three calendar years.

(d) *Designation of the Collective.* (1) The Judges designate SoundExchange, Inc., as the Collective to receive Statements of Account and royalty payments from Licensees and to distribute royalty payments to each Copyright Owner and Performer (or their respective designated agents) entitled to receive royalties under 17 U.S.C. 112(e) or 114(g).

(2) If SoundExchange, Inc. should dissolve or cease to be governed by a board consisting of equal numbers of representatives of Copyright Owners and Performers, then it shall be replaced for the applicable royalty term by a successor Collective according to the following procedure:

(i) The nine Copyright Owner representatives and the nine Performer representatives on the SoundExchange board as of the last day preceding SoundExchange's cessation or dissolution shall vote by a majority to recommend that the Copyright Royalty Judges designate a successor and must file a petition with the Copyright Royalty Judges requesting that the Judges designate the named successor and setting forth the reasons therefor.

(ii) Within 30 days of receiving the petition, the Copyright Royalty Judges must issue an order designating the recommended Collective, unless the Judges find good cause not to make and publish the designation in the Federal Register.

§ 380.5 Handling Confidential Information.

(a) *Definition.* For purposes of this part, “Confidential Information” means the Statements of Account and any information contained therein, including the amount of

royalty payments and the number of Performances, and any information pertaining to the Statements of Account reasonably designated as confidential by the party submitting the statement. Confidential Information does not include documents or information that at the time of delivery to the Collective is public knowledge. The party seeking information from the Collective based on a claim that the information sought is a matter of public knowledge shall have the burden of proving to the Collective that the requested information is in the public domain.

(b) *Use of Confidential Information.* The Collective may not use any Confidential Information for any purpose other than royalty collection and distribution and activities related directly thereto.

(c) *Disclosure of Confidential Information.* The Collective shall limit access to Confidential Information to:

(1) Those employees, agents, consultants, and independent contractors of the Collective, subject to an appropriate written confidentiality agreement, who are engaged in the collection and distribution of royalty payments hereunder and activities related directly thereto who require access to the Confidential Information for the purpose of performing their duties during the ordinary course of their work;

(2) A Qualified Auditor or outside counsel who is authorized to act on behalf of:

(i) The Collective with respect to verification of a Licensee's statement of account pursuant to this part; or

(ii) A Copyright Owner or Performer with respect to the verification of royalty distributions pursuant to this part;

(3) Copyright Owners and Performers, including their designated agents, whose works a Licensee used under the statutory licenses set forth in 17 U.S.C. 112(e) and 114 by the Licensee whose Confidential Information is being supplied, subject to an appropriate written confidentiality agreement, and including those employees, agents,

consultants, and independent contractors of such Copyright Owners and Performers and their designated agents, subject to an appropriate written confidentiality agreement, who require access to the Confidential Information to perform their duties during the ordinary course of their work;

(4) Attorneys and other authorized agents of parties to proceedings under 17 U.S.C. 8, 112, 114, acting under an appropriate protective order.

(d) *Safeguarding Confidential Information.* The Collective and any person authorized to receive Confidential Information from the Collective must implement procedures to safeguard against unauthorized access to or dissemination of Confidential Information using a reasonable standard of care, but no less than the same degree of security that the recipient uses to protect its own Confidential Information or similarly sensitive information.

§ 380.6 Auditing payments and distributions.

(a) *General.* This section prescribes procedures by which any entity entitled to receive payment or distribution of royalties may verify payments or distributions by auditing the payor or distributor. The Collective may audit a Licensee's payments of royalties to the Collective, and a Copyright Owner or Performer may audit the Collective's distributions of royalties to the owner or performer. Nothing in this section shall preclude a verifying entity and the payor or distributor from agreeing to verification methods in addition to or different from those set forth in this section.

(b) *Frequency of auditing.* The verifying entity may conduct an audit of each licensee only once a year for any or all of the prior three calendar years. A verifying entity may not audit records for any calendar year more than once.

(c) *Notice of intent to audit.* The verifying entity must file with the Copyright Royalty Judges a notice of intent to audit the payor or distributor, which notice the Judges must publish in the Federal Register within 30 days of the filing of the notice.

Simultaneously with the filing of the notice, the verifying entity must deliver a copy to the payor or distributor.

(d) *The audit.* The audit must be conducted during regular business hours by a Qualified Auditor who is not retained on a contingency fee basis and is identified in the notice. The auditor shall determine the accuracy of royalty payments or distributions, including whether an underpayment or overpayment of royalties was made. An audit of books and records, including underlying paperwork, performed in the ordinary course of business according to generally accepted auditing standards by a Qualified Auditor, shall serve as an acceptable verification procedure for all parties with respect to the information that is within the scope of the audit.

(e) *Access to third-party records for audit purposes.* The payor or distributor must use commercially reasonable efforts to obtain or to provide access to any relevant books and records maintained by third parties for the purpose of the audit.

(f) *Duty of auditor to consult.* The auditor must produce a written report to the verifying entity. Before rendering the report, unless the auditor has a reasonable basis to suspect fraud on the part of the payor or distributor, the disclosure of which would, in the reasonable opinion of the auditor, prejudice any investigation of the suspected fraud, the auditor must review tentative written findings of the audit with the appropriate agent or employee of the payor or distributor in order to remedy any factual errors and clarify any issues relating to the audit; Provided that an appropriate agent or employee of the payor or distributor reasonably cooperates with the auditor to remedy promptly any factual errors or clarify any issues raised by the audit. The auditor must include in the written report information concerning the cooperation or the lack thereof of the employee or agent.

(g) *Audit results; underpayment or overpayment of royalties.* If the auditor determines the payor or distributor underpaid royalties, the payor or distributor shall

remit the amount of any underpayment determined by the auditor to the verifying entity, together with interest at the rate specified in § 380.2(d). In the absence of mutually-agreed payment terms, which may, but need not, include installment payments, the payor or distributor shall remit promptly to the verifying entity the entire amount of the underpayment determined by the auditor. If the auditor determines the payor or distributor overpaid royalties, however, the verifying entity shall not be required to remit the amount of any overpayment to the payor or distributor, and the payor or distributor shall not seek by any means to recoup, offset, or take a credit for the overpayment, unless the payor or distributor and the verifying entity have agreed otherwise.

(h) *Paying the costs of the audit.* The verifying entity must pay the cost of the verification procedure, unless the auditor determines that there was a net underpayment (*i.e.*, underpayments less any overpayments) of 10% or more, in which case the payor or distributor must bear the reasonable costs of the verification procedure, in addition to paying or distributing the amount of any underpayment.

(i) *Retention of audit report.* The verifying party must retain the report of the audit for a period of not less than three years from the date of issuance.

§ 380.7 Definitions.

For purposes of this part, the following definitions apply:

Aggregate Tuning Hours (ATH) means the total hours of programming that the Licensee has transmitted during the relevant period to all listeners within the United States from all channels and stations that provide audio programming consisting, in whole or in part, of eligible nonsubscription transmissions or noninteractive digital audio transmissions as part of a new subscription service, less the actual running time of any sound recordings for which the Licensee has obtained direct licenses apart from 17 U.S.C. 114(d)(2) or which do not require a license under title 17, United States Code. By way of example, if a service transmitted one hour of programming containing

Performances to 10 listeners, the service's ATH would equal 10 hours. If three minutes of that hour consisted of transmission of a directly-licensed recording, the service's ATH would equal nine hours and 30 minutes (three minutes times 10 listeners creates a deduction of 30 minutes). As an additional example, if one listener listened to a service for 10 hours (and none of the recordings transmitted during that time was directly licensed), the service's ATH would equal 10 hours.

Collective means the collection and distribution organization that is designated by the Copyright Royalty Judges, and which, for the current rate period, is SoundExchange, Inc.

Commercial Webcaster means a Licensee, other than a Noncommercial Webcaster, Noncommercial Educational Webcaster, or Public Broadcaster, that makes Ephemeral Recordings and eligible digital audio transmissions of sound recordings pursuant to the statutory licenses under 17 U.S.C. 112(e) and 114(d)(2).

Copyright Owners means sound recording copyright owners, and rights owners under 17 U.S.C. 1401(l)(2), who are entitled to royalty payments made under this part pursuant to the statutory licenses under 17 U.S.C. 112(e) and 114.

Digital audio transmission has the same meaning as in 17 U.S.C. 114(j).

Eligible nonsubscription transmission has the same meaning as in 17 U.S.C. 114(j).

Eligible Transmission means a subscription or nonsubscription transmission made by a Licensee that is subject to licensing under 17 U.S.C. 114(d)(2) and the payment of royalties under this part.

Ephemeral recording has the same meaning as in 17 U.S.C. 112.

Licensee means a Commercial Webcaster, a Noncommercial Webcaster, a Noncommercial Educational Webcaster, a Public Broadcaster, or any entity operating a noninteractive Internet streaming service that has obtained a license under 17 U.S.C. 114

to make Eligible Transmissions and a license under 17 U.S.C. 112(e) to make Ephemeral Recordings to facilitate those Eligible Transmissions.

New subscription service has the same meaning as in 17 U.S.C. 114(j).

Noncommercial Educational Webcaster means a Noncommercial Educational Webcaster under subpart C of this part.

Noncommercial Webcaster has the same meaning as in 17 U.S.C. 114(f)(4)(E), but excludes a Noncommercial Educational Webcaster or Public Broadcaster.

Nonsubscription transmission has the same meaning as in 17 U.S.C. 114(j).

Payor means the entity required to make royalty payments to the Collective or the entity required to distribute royalty fees collected, depending on context. The Payor is:

- (1) A Licensee, in relation to the Collective; and
- (2) The Collective in relation to a Copyright Owner or Performer.

Performance means each instance in which any portion of a sound recording is publicly performed to a listener by means of a digital audio transmission (*e.g.*, the delivery of any portion of a single track from a compact disc to one listener), but excludes the following:

- (1) A performance of a sound recording that does not require a license (*e.g.*, a sound recording that is not subject to protection under title 17, United States Code);
- (2) A performance of a sound recording for which the service has previously obtained a license from the Copyright Owner of such sound recording; and
- (3) An incidental performance that both:
 - (i) Makes no more than incidental use of sound recordings including, but not limited to, brief musical transitions in and out of commercials or program segments, brief performances during news, talk and sports programming, brief background performances during disk jockey announcements, brief performances during commercials of sixty

seconds or less in duration, or brief performances during sporting or other public events;
and

(ii) Does not contain an entire sound recording, other than ambient music that is background at a public event, and does not feature a particular sound recording of more than thirty seconds (as in the case of a sound recording used as a theme song).

Performers means the independent administrators identified in 17 U.S.C. 114(g)(2)(B) and (C) and the parties identified in 17 U.S.C. 114(g)(2)(D).

Public broadcaster means a Public Broadcaster under subpart D of this part.

Qualified auditor means an independent Certified Public Accountant licensed in the jurisdiction where it seeks to conduct a verification.

Subscription transmission has the same meaning as in 17 U.S.C. 114(j).

Transmission has the same meaning as in 17 U.S.C. 114(j)(15).

3. Revise subpart B to read as follows:

Subpart B - Commercial Webcasters and Noncommercial Webcasters

§ 380.10 Royalty fees for the public performance of sound recordings and the making of ephemeral recordings.

(a) *Royalty fees.* For the year 2021, Licensees must pay royalty fees for all Eligible Transmissions of sound recordings at the following rates:

(1) *Commercial webcasters.* \$0.0026 per Performance for subscription services and \$0.0021 per Performance for nonsubscription services.

(2) *Noncommercial webcasters.* \$1000 per year for each channel or station and \$0.0021 per Performance for all digital audio transmissions in excess of 159,140 ATH in a month on a channel or station.

(b) *Minimum fee.* Licensees must pay the Collective a minimum fee of \$1,000 each year for each channel or station. The Collective must apply the fee to the Licensee's account as credit towards any additional royalty fees that Licensees may incur in the

same year. The fee is payable for each individual channel and each individual station maintained or operated by the Licensee and making Eligible Transmissions during each calendar year or part of a calendar year during which it is a Licensee. The maximum aggregate minimum fee in any calendar year that a Commercial Webcaster must pay is \$100,000. The minimum fee is nonrefundable.

(c) *Annual royalty fee adjustment.* The Copyright Royalty Judges shall adjust the royalty fees each year to reflect any changes occurring in the cost of living as determined by the most recent Consumer Price Index for All Urban Consumers (U.S. City Average, all items) (CPI-U) published by the Secretary of Labor before December 1 of the preceding year. The calculation of the rate for each year shall be cumulative based on a calculation of the percentage increase in the CPI-U from the CPI-U published in November, 2020 (260.229) and shall be made according to the following formulas: for subscription performances, $(1 + (C_y - 260.229) / 260.229) \times \0.0026 ; for nonsubscription performances, $(1 + (C_y - 260.229) / 260.229) \times \0.0021 ; for performances by a noncommercial webcaster in excess of 159,140 ATH per month, $(1 + (C_y - 260.229) / 260.229) \times \0.0021 ; where C_y is the CPI-U published by the Secretary of Labor before December 1 of the preceding year. The adjusted rate shall be rounded to the nearest fourth decimal place. The Judges shall publish notice of the adjusted fees in the FEDERAL REGISTER at least 25 days before January 1. The adjusted fees shall be effective on January 1.

(d) *Ephemeral recordings royalty fees; allocation between ephemeral recordings and performance royalty fees.* The Collective must credit 5% of all royalty payments as payment for Ephemeral Recordings and credit the remaining 95% to section 114 royalties. All Ephemeral Recordings that a Licensee makes which are necessary and commercially reasonable for making noninteractive digital transmissions are included in the 5%.

Dated: September 20, 2021.

Jesse M. Feder,
Chief Copyright Royalty Judge.

Approved by:

Carla D. Hayden,
Librarian of Congress.

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